

**Testimony of John Hassell
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**before the
Senate Committee on Foreign Relations Subcommittee on European
Affairs**

**Hearing to examine the United States-European Union regulatory
cooperation on emerging technologies**

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Good afternoon. My name is John Hassell. I am the Director for Federal and State Government Affairs for the Hewlett-Packard Company. HP is a technology solutions provider to consumers, businesses and institutions globally. The company's offerings span IT infrastructure, global services, business and home computing, and imaging and printing, with annual revenue exceeding \$81 billion.

I thank the Committee for hosting this hearing and for giving me the opportunity to testify today. We applaud that you have chosen for consideration three issues of critical importance to HP. In my testimony, I intend to address the increasingly important issue of European "private copy levies."

As my testimony will demonstrate, levies are now outdated and pose a significant threat to the interests of authors, consumers and technology developers. They were developed almost 50 years ago, at a time when it was impossible to ensure that authors received fair compensation for uses of their music or movies. Today, technologies like digital rights management make it possible for both the consumer to fully enjoy the work while preventing unauthorized uses. The tax-like levy raises costs to all, and creates the misimpression that piracy is sanctioned. This was never the goal of levies, and it constitutes bad public policy.

We believe that circumstances have evolved to the point where the rough justice that justified levies in the first place is no longer good policy. EU law recognizes this change. But many European countries persist not only in maintaining their levies regimes, but in expanding them to new

areas. The net result is increased costs to consumers, who end up paying two or three times for the music and movies they acquire.

We seek your support in addressing this challenge. More specifically, we ask that the Subcommittee support the EU's efforts to address national levies regimes through its upcoming Directive on collective rights management. We also recommend that US Trade Agreements include language opposing the establishment of new levy systems and calling for the phase-out of existing levies.

Origin of Copyright-Related Levies

I would like to start my testimony by offering a brief explanation of the origins of the levy system in Europe for those of you unfamiliar with this system.

Many European Union Member States have what is known as a "private copy exception" in their copyright laws. This exception permits users in certain situations to reproduce copyrighted works such as music and movies for personal use. (Notably, there is no private copy exception for software).

This exception raised a problem of remuneration for authors, however. In the days of analog works, it was extremely difficult for authors and right holders to monitor or administer the private copy exception. There was no effective way for right holders to control how and when private copies of their copyrighted works were made. Similarly, there was no effective way for them to track the number of private copies being made or to be remunerated directly for those copies.

The levies system emerged in the 1960s as a response to those challenges. In essence, a levy is similar to a tax added to the purchase price of blank media and recording and reproduction devices. Many European states now have legislation that allows national "collecting societies" (independent and quasi-governmental associations responsible for administering levies regimes) to set the amount of the levy, determine the media and devices that would be covered by the levy and handle distribution of the funds collected. As a general matter, a percentage of the levy collected is distributed to authors and right holders; a percentage is used for the cost of administering the levy; and, in some instances, an amount is also set aside to support national cultural funds or projects.

Although so-called "private copy" levies have never been able to accurately reflect the actual value and use of any particular work, they

were deemed to be the only practical method to compensate right holders for private copy exceptions in the analog era. In short, levies reflected a compromise solution in a world where the technology did not exist to manage particular uses of works.

Levies Today: the Digital Dimension

In today's digital world, the fundamental premise that underlies levy regimes—the author's inability to control private uses of his or her work—has been eroded dramatically. Indeed, technology now enables right holders to exercise far greater control over the use of their works and to be compensated accurately for such uses.

These technologies are commonly referred to as “digital rights management” technologies or “DRMs”. DRMs are among the most important and most exciting emerging technologies. While these technologies are complex in their workings, what they mean at a practical level is that authors and right holders are able to control how their works are enjoyed and to set license fees accordingly. Authors, composers, recording companies and even collecting societies are now using DRM systems to identify content and authors, to set forth acceptable uses, to establish prices and to grant licenses directly and automatically to individual users. At the same time, DRMs enhance the consumer experience as well, by offering new and simpler ways for users to enjoy copyrighted works.

HP is very active in the DRM space. Our activities in this area, which are focused on enhancing the consumer experience, building reasonable solutions for respecting creative content, and respecting copyright, include the following:

- HP created HP DVD Movie Writer, the first system in the industry to respect digital rights, informing the consumer only when content cannot be legally copied;
- HP allied with Apple on iTunes and iPod to deliver the best music experience possible;
- HP developed VCPS with Philips, and licensed other industry leading DRM technologies;
- HP collaborates with numerous standards bodies and industry consortia to further next generation technologies, such as the Advanced Access Copyright System, Open Mobile Alliance DRM, Content Management Licensing Administrator, and DVD Copy Control Association.

- HP is a founding member of the Coral Consortium, a cross-industry group to promote interoperability between DRM technologies used in the consumer media market.

The above are only a few examples of HP's commitment to ensuring a simple, affordable and enjoyable entertainment experience that is supported by a fair business model for content providers.

Tools like the ones described above are enabling right holders to manage their works directly and thus are eliminating the need for traditional levies. In light of these developments, one would anticipate that levies would be scaled back. This has not been the case, however. Instead, we have consistently seen the expansion of levies regimes throughout Europe—including the systematic extension of levies to digital media and equipment and an ongoing increase in the amount of levies demanded by collecting societies.

It is important to note that the expansion of levies is happening *despite* a 2001 law adopted by the European Union that instructs Member States to the contrary. The EU "Copyright Directive"—which brings European copyright law into the digital age—makes clear that levy regimes must be adjusted to reflect the application of DRMs. The majority of Member States and national collecting societies have yet to implement this obligation in practice, however.

Instead, despite the increasing usage of DRMs, national collecting societies are applying levies to an expanded universe of products. Depending on national legislation, levies are being extended to digital equipment such as PCs, printers, mobile-phones, personal video recorders and portable music players, fax machines, copiers, scanners as well as to a wide variety of media (hard disks, memory cards, CD-R, DVD-R). In some Member States, proposed levies have exceeded the cost of the product being levied. In others, competing collecting societies are seeking levies on the same products.

To take just one example of particular significance to HP, in Germany, a high profile case brought by the collecting society VG Wort against Fujitsu Siemens has extended the levies regime to PCs, notebooks and servers. After unsuccessful negotiations with industry, VG Wort chose to bring a test case against Fujitsu Siemens, arguing that its products could be used for copying and therefore should be subject to levies. Earlier this year, its claim was successful and in fact, the court initially declared that the levy should be applied retroactively to include all machines sold since 2001, when the claim was first made. (The court did rule, however, that the levy

should be 12 Euros for each new PC sold rather than 30 Euros as originally sought by the collecting society.) Fujitsu Siemens was supported during the proceedings by other hardware manufacturers, including HP, and has filed an appeal against the decision. The ultimate decision will apply to other manufacturers as well.

The German levy would be in spite of the fact that PCs are used for many other purposes than making private copies of copyrighted works. (As noted, there is no private copy exception for software and thus no levy applicable to software reproductions). Similar litigation is under way between VG Wort and HP and Lexmark, concerning attempted levies sought on printers. Applying levies to multi-functional products necessarily opens the door to the application of levies to all sorts of other hardware equipped with memory chips: radio and television sets, digital cameras, digital video units, telephones, car stereos, automobile information systems, watches—the possibilities are endless. If this path is followed, an increasingly large number of users will end up subsidizing the activities of a small group of private copiers.

The Impact of Levies on Digital Products

Before reviewing the broad and often detrimental effects of digital private copy levies, let me begin by saying that HP is committed to fair and full remuneration for rights owners for the use of their products. What we question is whether levies are the best way to attain this end—especially in light of digital developments which call into question the necessity of levies. HP hopes to partner with interested stakeholders in the transition away from a levies-based system to a world of reasonable, consumer-friendly solutions for respecting creative content.

- **The Impact on Consumers**

Levies as a general rule are paid by IT product manufacturers and importers. Ultimately, however, the consumer shares this burden.

Where DRMs are in place, a levy on digital products means a consumer may pay two or more times for private copies. For example, when a consumer purchases her favorite song through a DRM-enabled on-line music store for use on her MP3 player, the artist receives a direct payment for her use of the song and for a specified number of “private” copies. If collecting societies have their way, that consumer will also pay a levy on the device. If she stores the song in her PC, she might pay a levy on the PC, on the CD-burner embedded in the PC and on the blank CD used to hold the song.

The increasing popularity of on-line music and movies services that employ DRM technologies and the increasing number of digital devices covered by the levy system can only mean that more and more consumers will be charged multiple times for the right to make a copy. This decreases consumer enthusiasm for DRMs. It also means right holders have little incentive to apply DRMs to their works.

At a more general level, levies are a tax on digital products. As such they raise the cost of technology to a country's citizens. When a collecting society establishes a levy on a new product or raises the price of a levy on an existing product, the increased price necessarily results in a lower demand for such products. The result of this "tax" is that fewer people possess the newest technological products, slowing the uptake of new technologies and widening the digital divide. This tax also suppresses sales by US information and communication technology (ICT) companies in Europe and reduces investment in, and the development of, DRM-enabled businesses like those that have flourished in the United States.

- **Impact on Industry**

Two major studies have been conducted to calculate the significant costs to industry that levies impose. The first study, undertaken by Rightscom and commissioned by the Business Software Alliance in September 2003¹, examined the impact of levies in France, Germany, Italy, the Netherlands and Spain. The study predicted that between 2002 and 2006 the total amounts of levies collected in these five countries would increase by threefold—from \$380 million in 2003 to over one billion US dollars in 2006. This analysis was based on the fact that levies now cover more products and that levy rates are increasing. If proposed levies on additional products, such as the German levy on PCs, continue to be enforced, the study estimated that the total amount collected in 2006 could increase to over \$1.5 billion.

A second study sought to assess lost sales (of PCs, portable music players, and printers) as a result of increased prices brought-about by the private copy levies. This study from Nathan Associates², concludes that the cost of levies to the technology industry, depending on the elasticity of the price of the product, could range from \$808 million to \$8.8 billion per year.

¹<http://www.bsa.org/customcf/popuphitbox.cfm?ReturnURL=/eupolicy/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=10369>

² Presentation delivered in Maryland, USA "Impact of Content Rights Compensation Levies: Lost Sales Revenue Worldwide." April 28, 2003, Robert Damuth, Vice President Nathan Associates, www.nathaninc.com.

These costs are staggering. Few but the largest technology providers can bear them. And faced with demands that can be both arbitrary and unpredictable and that differ from one Member State to another, levies also impair industry's ability to develop coherent, EU-wide business strategies. Add to this the fact that levies on digital products suppress demand for those products and hinder the roll-out of DRM-enabled content delivery systems and the reason for the concern of the technology industries becomes evident.

- **Impact on authors and right holders**

Even authors and right holders—the intended beneficiaries of levy systems—have significant concerns with how these systems are operated. Many of these revolve around the transparency of the system and the way in which levies are distributed. At present, it can be difficult for authors (and consumers and manufacturers as well) to understand how levy rates are assessed, on what products they apply and how they are distributed.

In a number of countries, for example, an artist will only receive compensation if he or she is a member of a particular collecting society—leaving non-members with little recourse. Because a portion of the funds collected are used to pay the collecting societies' administrative expenses, right holders often receive distributions that represent only a fraction of what they would receive if they were compensated directly.

- **Contribution to piracy**

As this Committee knows well, right holders suffer significant harm as a result of copyright piracy. Users of digital audio and audio-visual works can and do mistake private copy levies—which are intended to compensate right holders for lawful private copying only—for an “open-license” to copy content freely. Levies quickly become a “license to pirate”. At the same time, the presence of levies in a market can also hamper or undermine investment in DRM-enabled products and services that would seem to offer the best avenue for curtailing rampant illegal file-sharing.

Recommendations to the Subcommittee

Before making any recommendations, I want to stress the EU's constructive role on this issue. As I noted above, European law includes many important safeguards to avoid the unfettered expansion of levies

regimes. The EU has worked closely with HP and other companies in an effort to ensure these limitations are respected in practice. For this, we are grateful.

I also want to reiterate HP's commitment to DRM technologies and to ensuring regulatory systems that enable, rather than obstruct, these technologies. It is part of HP's core mission to ensure and advance the consumer's ability to easily enjoy entertainment on any device, in any format, while making new business models possible. Levies, improperly considered, can and do stand in the way of this mission.

This is why HP and other technology providers have been extremely active on the levies issue in Europe both independently and through trade associations including the Business Software Alliance and EICTA, the European ICT industry association.

We respectfully request the Committee's support in our efforts:

- First, we urge the Committee to express its support for EU efforts to rationalize national levies regimes. Led by its Directorate on the Internal Market, the EU is currently considering broad-based legislation on collective rights management. The ICT industry in Europe has called upon the EU to take this opportunity to review the functioning of national levies regimes and impose clear parameters on national efforts to expand those regimes into the digital arena. We ask that you communicate support for our request to your counterparts in Europe. We understand that there is an EU-US Ministerial Summit scheduled for June 2005. This might be an appropriate opportunity to express the US Government's interest and concerns surrounding this issue.
- At the same time, countries outside of Europe are studying whether they should expand levies regimes to cover digital products. We believe US Trade Agreements should include language opposing the establishment of new levy systems and calling for the phase-out of existing levies. We ask for your support in this effort.

I thank you for your time today and I stand ready to answer any questions you may have.