

TESTIMONY OF
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BEFORE THE
SUBCOMMITTEE ON EUROPEAN AFFAIRS
COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

HEARING ON
“U.S. - E.U. REGULATORY COOPERATION ON
EMERGING TECHNOLOGIES”

MAY 11, 2005

SUMMARY

The transatlantic relationship is one of the most important in the world. Bilateral trade and investment are powerful forces that have fostered prosperity and stability between the U.S. and Europe, as well as much of the world, stimulating innovation, investment, economic growth, and job creation in both the U.S. and Europe.

These goals are at risk today from the lack of a uniform, rational and modern system of managing copyright protection in Europe. Indeed, the myriad national copyright levy regimes in existence today in Europe, managed by secretive and unaccountable “collecting societies,” are remnants of a bygone analog era that, when applied in today’s digital world, threaten to stifle otherwise robust consumer demand for new digital products and services, and perversely undermine innovation in technologies that offer the very intellectual property rights protection that they are intended to promote.

Today, a company seeking to introduce a new digital device or media to European consumers, including PC hard drives, MP3 players, DVD player/recorders, blank DVDs, and CDs, faces a gauntlet of as many as 20 different national copyright levy regimes, all of which vary considerably in terms of rate, scope, complexity, structure, and payment processes. The net effect of these disparate and unreasonably high copyright levies is nothing less than a toxic investment environment for U.S. and European companies, including Philips, that are at the forefront of digital technology innovation, and stands in marked contrast to the U.S. approach of promoting innovation and economic growth in IP services by shielding it from these very types of redundant and excessive taxes. Philips suggests the negative consequences of this increasingly out-of-control levies system on global economic growth and technological innovation are so serious and immediate that reform of the system should be accorded priority at next month’s U.S.-E.U. Summit. These reforms should target three specific areas:

Harmonization – The maze of disparate national copyright levies across European Union Member Countries distorts cross-border trade and creates massive inefficiencies and costly administrative burdens, increasing the final sales price to consumers of many products and creating major uncertainty regarding the ultimate potential liability of manufacturers. Potential reforms in this area might include standardized levies on agreed upon products throughout Europe or eliminating the individual levies collected directly by collecting societies in favor of payment of a fixed amount from a VAT tax.

Better Governance and Increased Transparency – There is a severe lack of basic “good governance,” transparency and accountability in the way that national collecting societies operate. Uneven enforcement is a major problem, and has resulted in competitively disadvantaging the larger, leading manufacturing companies, who bear the brunt of the levies, and virtually ignoring our smaller competitors. Philips and the EABC support efforts being undertaken by the E.C. to impose “good governance” rules on collecting societies, and urges that reforms be enacted to make processes open, transparent and nondiscriminatory; afford stakeholders the ability to contest tariffs through efficient, open and cost-effective procedures conducted by an independent third party; and require advance, public disclosure about levy collection and distribution.

Modernization That Emphasizes Digital Content Protection Technology Solutions – Technology innovators, content owners and the European Commission all agree that levies-based copyright protection systems are archaic in light of the digital technology alternatives, such as digital rights management. Copyright regimes must be modernized not only to reflect the existence and effectiveness of these technologies, but to promote their development and use.

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Thank you, Chairman Allen, Ranking Member Biden and Members of the Subcommittee. My name is Tom Patton, and I am Vice President for Government Relations with Philips Electronics North America Corporation, a subsidiary of Royal Philips Electronics headquartered in Amsterdam, The Netherlands. On behalf of the European-American Business Council, Philips welcomes the opportunity to participate in this Subcommittee’s hearing on U.S. and European regulations affecting emerging technologies.

Philips is a diversified global technology company employing more than 160,000 employees in over 60 countries worldwide, roughly 30,000 of whom work in the United States. Philips is a company focused on the physical and emotional well-being of its customers, manufacturing products as varied as defibrillators and medical diagnostic equipment, electric toothbrushes, electric shavers, and a full range of video and audio entertainment products from digital televisions to the Jukebox MP3 player. Philips is currently number 1 in the global markets for lighting, electric shavers, and DVD recorders, and we’re number 2 in medical diagnostic imaging worldwide. Philips Consumer Electronics is the third largest consumer

electronics company in the world and the largest in Europe. Together with Sony, Philips invented the technology that enabled the development of the CD and DVD industries. Our company invests more than a billion dollars annually in research and development and holds more than 115,000 patents.

The transatlantic economic relationship is one of most important in the world. Bilateral trade and investment are powerful forces that have fostered prosperity and stability between the U.S. and Europe, as well as much of the world. In 2003, total transatlantic commercial exchanges reached \$2.5 trillion, generating \$77.1 billion in earnings for U.S. affiliates in Europe and \$46.4 billion for European affiliates in the US. In that same period, total U.S. investment in Europe was \$800 billion and total European investment in the U.S. was more than \$1 trillion. Not surprisingly, this investment is a major engine for job growth, with 4.2 million people employed in the U.S. by European affiliates and 3.2 million people employed in the E.U. by U.S. affiliates. With eleven percent of the world's population and forty percent of its GDP, the U.S. and E.U. together are both an engine for global growth and leaders in standards-setting for the world. The European-American Business Council is committed to fortifying U.S.-E.U. economic integration, growth and competitiveness through regulatory convergence and free exchange of goods, services and capital. EABC pursues mutually beneficial solutions to US-E.U. trade barriers through enhanced government-to-industry dialogue across the Atlantic.

THE NATIONAL COPYRIGHT LEVY SYSTEM IN EUROPE IS BROKEN

My testimony today addresses a matter of real consequence to global economic growth and future technological innovation, and in particular, to the development and introduction of new and effective digital content protection technologies, exciting consumer digital entertainment devices and IT services. There is an urgent need to harmonize, rationalize, and

modernize the laws and regulations that govern how intellectual property rights are protected and compensated in the European market.

Currently, throughout Europe, there exists a system of copyright levies, collected and distributed on a country-by-country basis throughout the E.U. by national entities known as “collecting societies.” The purpose of these levies, which originated in the analog era, is to provide remuneration to authors, artists, and other intellectual property rights holders for certain uses of copyrighted works, some of which, such as certain home copying, are not subject to copyright control in the U.S. As these levies are being imposed in today’s digital world, however, they are causing serious market distortions, threaten to stifle otherwise robust consumer demand for new digital products and services, and perversely undermine the very intellectual property rights protection that they are intended to promote.

Absent swift and sweeping reform of the myriad national copyright levy regimes operating in Europe, technology companies such as Philips face an unacceptable array of risks and potential liability, all of which deter investment in new digital rights management and other advanced digital content protection systems needed to prevent mass, indiscriminate, unauthorized redistribution of digital video and audio content over the Internet. The amount of levies imposed upon new high-tech products, often based upon storage capacity, creates a lack of predictability and may artificially constrain consumer functionality because the levies militate against incorporating greater storage capacity. The balance of trade deficit for the United States will worsen because both the American entertainment and high-tech industries stand to lose significant revenues under the current levy system.

The negative consequences of this increasingly out-of-control system of levies on global economic growth and technological innovation are so serious and immediate that reform of the system should be accorded real priority in next month's U.S.-E.U. Summit.

Of particular concern to Philips is the evolution of these copyright levies — functionally consumer taxes — on the sale of virtually anything capable of storing or recording digital data. Today, a company seeking to introduce a new digital device or media to European consumers, including PC hard drives, MP3 players, DVD player/recorders, blank DVDs, and CDs, faces a gauntlet of as many as 20 different national copyright levy regimes, all of which vary considerably in terms of rate (as well as the metrics used to assess that rate), scope, complexity, structure, and payment processes.

For example, in France, levies imposed by SACEM on blank DVDs now represent more than 47 percent of the final price for the consumer. In Germany, where there is a levy on PC hard drives, as disk drive sizes expands to terabytes in notebooks and petabytes in home DVRs, the tax will far outweigh not just the cost of the drive, but the cost of the entire device! In Spain, a multi-function copier/fax/printer costs around €79 (approx. \$102) (including 16% VAT). Spain's collecting society, SGAE, imposes a levy on that device of slightly more than €45, which is also subject to a 16% VAT, thus increasing the final price to the consumer by 66 percent, to €131 (approx. \$170). In Austria, the exorbitant levy imposed upon MP3 players has caused Philips to delay introduction of its "Jukebox" product in that country.

The trend line is clear. Ever-increasing levy rates are being exacted by national collecting societies across Europe without any semblance of uniformity on an ever-increasing number of digital consumer electronics devices and blank media. To make matters worse, the irregular manner in which these levies are imposed and enforced disproportionately harms the

most innovative technology companies, often ignoring entirely lesser-known “copy-cat” manufacturers. Indeed, in a perverse twist, the more modern the product, the more cutting-edge the technology, and the earlier its introduction to the market, the greater is the risk. In short, the national levy system in Europe turns all of the fundamental laws of capitalism on their head.

The net effect of these disparate, unevenly enforced and unreasonably high copyright levies is nothing less than a toxic investment environment for U.S. and European companies, including Philips, that are at the forefront of digital technology innovation. How can technology companies justify the enormous initial investments required for innovation, including innovation in the very types of technologies that offer a better solution to protecting digital content, if they cannot even plan new products because of the unpredictable effect of ever-increasing and redundant copyright levies? The answer is they cannot.

It’s important to point out that the current approach in many E.U. Member Countries to tax emerging technologies as much as possible stands in marked contrast to that of the U.S., particularly this country’s decision – thanks in large part to your leadership, Mr. Chairman – to promote innovation and economic growth in Internet-based services by shielding them from these very types of redundant and excessive taxes. Thank you. We hope you will agree that, for the sake of preserving and promoting a vibrant and healthy transatlantic economy, and the enormous benefits that clearly flow from that, a similar approach is desperately needed in Europe.

NEEDED REFORMS

There are three distinct areas of reform that need to be undertaken immediately: harmonization, vastly increased transparency, and, most importantly, a fundamental re-examination leading to modernization.

1. HARMONIZATION

Despite the continued best efforts of the European Commission (initially through its adoption its 2001 Copyright Directive (implementing its obligations under the WIPO Treaty) and today in its pending review of Member Countries' implementation of that Directive) to attempt to foster a more harmonized and rational system of laws to protect intellectual property and preserve and promote technology innovation and competition, uneven and incomplete implementation of these objectives by E.U. Member Countries has unfortunately resulted in a patchwork quilt of outmoded, inefficient and excessive levies – either increasing the final sales price to consumers of many products or impeding their introduction into the market altogether. This maze of disparate copyright levies distorts cross-border trade and creates massive inefficiencies and costly administrative burdens. It competitively disadvantages leading manufacturing companies which bear the brunt of the levies. Potential reforms in this area might include standardized levies on agreed upon products throughout Europe or eliminating the individual levies collected directly by collecting societies in favor of payment of a fixed amount from a VAT tax.

2. GOVERNANCE AND TRANSPARENCY

There also is a need to address the severe lack of basic “good governance,” transparency and accountability in the way that national collecting societies operate. Incredibly, the manner in which these quasi-governmental, quasi-private entities operate and set levies is closed to public

scrutiny with little meaningful opportunity for stakeholders to participate in the levy-setting or distribution processes or to object to these levies once established. The arbitrary and discriminatory manner in which these levies are enforced is contrary to every basic tenet of fairness. Moreover, even most of the largest and most creative content owners, whose intellectual property rights these levies are supposed to protect, strongly oppose the current system because it does not serve the core purpose of protecting their digital content; instead it simply favors a select group of domestic rights holders or other pet parochial projects.

Philips supports efforts being undertaken by the E.C. to impose “good governance” rules on collecting societies, and agrees that such rules are crucial. In particular, processes should be open, transparent and nondiscriminatory. Stakeholders should be able to contest tariffs through efficient, open and cost-effective procedures conducted by an independent third party, with appeal to the E.U. as necessary and appropriate. Similarly, collection societies should be required to publish detailed information on the amounts they collect and the distributions they make.

3. MODERNIZATION THAT EMPHASIZES DIGITAL CONTENT PROTECTION TECHNOLOGY SOLUTIONS

The problems with the national system of copyright levies are so acute today that these first two major areas of reforms must be implemented right away. They are not, however, substitutes for a fundamental re-examination of the levy system and development of a modernized system that reflects the realities – and responds to the imperatives – of the digital era in which we now live.

Technology companies such as Philips and major copyright owners such as U.S. motion picture studios and record companies stand united in the belief that the advent of digital

technology demands a new paradigm in which digital content protection technologies and digital rights management systems – not taxes – play a paramount role in ensuring that rights owners are appropriately and adequately compensated for their works and that those works are better protected from indiscriminate, unauthorized redistribution.

In fact, levies-based copyright protection systems are nothing less than archaic in light of the digital technology alternatives. Technology-based solutions make it easier for content owners to identify authors and articulate terms of usage, to establish prices and collect payment, and to determine, among other things, how content is delivered, accessed and copied. As these technologies evolve, content providers are discovering new ways to use them, developing exciting new business models that allow them to better satisfy a broad spectrum of user requirements. The ultimate beneficiaries of these developments, of course, are consumers, who can enjoy greater and more user-friendly opportunities to access and interact with digitally-distributed content.

It is no wonder that the content industry prefers DRM-based solutions over private copy levies. As one major content industry association executive recently stated, “Private copy levies ... impose a cost on all consumers, whether or not they copy, and distribute the proceeds imprecisely and with high overhead.”

For these reasons, Philips and the EABC agree with European Commission that DRM solutions represent “...an important, if not the most important, tool for rights management in the [European] market of the new digital services.” Indeed, we urge that copyright regimes must be modernized not only to reflect the availability and effectiveness of these technologies, but to promote their development and use.

The outlook for technology alternatives in the European context, however, is not particularly good. Just last month, a French court, reversing a lower court ruling in the *Que Choisir* case, ruled that DRM-based security features on DVDs are actually *illegal*, as they violate that country's private copying right. In this new digital environment, it is more important than ever that intellectual property laws and regulations strike an appropriate balance between a consumer's right to copy for personal and non-commercial use, and content owners' right to protect their works from unauthorized redistribution especially over the Internet. By outlawing DRM solutions for DVDs, the French court's decision does not appear to recognize or respect the need for such a balance, and, unless overturned, that decision could harm innovation and uptake of similar technologies solutions that offer much needed relief from that and other E.U. countries' oppressive system of levies.

CONCLUSION

The current system of balkanized, excessive and secretive national copyright levies in Europe is so flawed and so potentially harmful to global economic growth and technological innovation that it demands immediate, high level transatlantic cooperation. It would be most productive if this topic could be given high priority at the United States-European Union Summit next month.

Again, I thank you for the opportunity to appear before this Subcommittee and would be pleased to answer any questions.