



The
Carrot or the
Stick?

Innovation vs. Anti-Piracy Enforcement

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Carrot or Stick?

The entertainment industries, led mainly by the recording and film industries, have led a worldwide campaign to try to ratchet up “anti-piracy” laws in countries around the globe over the past five years. The pattern is fairly similar — with the industry convincing a politician in one country to launch a particular plan, followed by pressure on a variety of other countries to copy that particular approach. Often, this is followed up with attempts to use international trade arenas to pressure more countries to adopt similar policies.

But there’s a real question as to whether or not these regulatory changes have been, in any way, effective in either reducing the amount of piracy in these countries or in increasing revenue opportunities for the creative industries. Over the past few years, there have been some very positive signs for those industries, as a growing number of people have signed up for popular authorized services.

These two factors raise a serious question: is the success due the rise in innovation — in the form of a growing number of authorized services that people find convenient and effective — or is it because of the legal changes? In short, is it the carrot (innovation) or the stick (anti-piracy legislation) that is leading us into this new world? That is what this research report seeks to answer.

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The Carrot

THE RISE OF AUTHORIZED SERVICES

At the same time that the industry has made this push, we have seen a rapid growth and global expansion of a variety of authorized services in the entertainment field, with much of the focus on the music side — with services like Spotify, Deezer, Rdio and others spreading rapidly around the globe. A number of new entrants have jumped into the space as well, sometimes offering unique business models or features, in trying to attract new users.

The adoption of these services has exploded over time, with many showing rapid user and subscriber growth rates. Multiple studies have shown that as these kinds of services are adopted, the rate of unauthorized downloading drops significantly, suggesting that these services are clear competitors to piracy.



The Stick

THE PUSH FOR ANTI-PIRACY LEGISLATION

Around 2008/2009, the industry really ramped up its concerted effort to pass anti-piracy laws around the globe. The focus was mostly on what is known as “graduated response” or “three strikes” rules, that would cause individuals to receive punishments up to and (sometimes) including losing their internet connection, following accusations (not convictions) of copyright infringement.

More recently, the industry focus has been on “site blocking” laws that focus mainly on trying to get countries to require ISPs to block access to certain “rogue sites” that are seen as enabling infringing activities.

Throughout all of this, the industry has continually sought to increase the penalties given to those convicted, or to put more pressure and liability on service providers and intermediaries if their services were used for infringing purposes.

Which One Wins?

In this report, we look at several different countries, particularly at ones which passed stringent anti-piracy laws or enacted tougher copyright enforcement in the past few years: France, United Kingdom, Sweden, South Korea, Japan and New Zealand, and explore whether the evidence suggests the carrot or the stick is the most effective approach — or if it’s a combination of the two that is most effective.

One of the most obvious approaches to this question turns up few answers. The costs of enforcing new or existing laws is rarely weighed against the benefits. French culture minister Aurélie Filippetti expressed that HADOPI enforcement was too expensive and “failed in its mission to develop legal alternatives.” Anti-piracy legislative efforts often take years to develop, and technology progresses much faster. In South Korea, legal efforts directed at ‘webhards’ or cyberlockers simply encouraged internet users to use file sharing networks instead.

Ultimately, what we find is that the data across several countries strongly supports the carrot approach of encouraging and enabling greater innovation, while finding little support for stricter laws (which may also create other unintended consequences). The evidence to support the claim that stricter anti-piracy laws leads to a long-term decrease in piracy or

an enduring increase in sales is difficult to find. There is evidence that strong anti-piracy laws have a short-term impact leading to a brief, if sometimes significant, decline in unauthorized access.

However, in nearly every case, that decline generally appears to be short-lived and, within months, users have found easily accessible alternatives.

At the same time, the evidence is quite strong that greater innovation, in the introduction of successful authorized services, appears to lead to noticeable and long-lasting reductions in infringement. This can be seen in the timing of the changes, as well as by looking at the piracy rates across different forms of content. Notably, in many cases, after the introduction of new anti-piracy laws (which apply across the board to all kinds of copyright-covered content), we see very little impact on piracy in other industries, such as software. If the law is an effective deterrent, we would expect to see a decline in such piracy as well.

We also see a pretty clear correlation between successful new authorized services and changing fortunes in these industries, along with a general decrease in piracy. For example, in Sweden, the success of Spoti-

fy showed a major decline in the file sharing of music on The Pirate Bay, but a similar move was not seen in the file sharing of TV shows and movies... until Netflix opened its doors in Sweden.

Finally, we found little evidence to suggest that the combination of the carrot and the stick is needed. While some entertainment industry executives have argued that these kinds of anti-piracy laws are necessary for authorized services to feel comfortable launching in these countries, the evidence suggests this is simply not true. In multiple countries that we studied, we saw that a vast increase in the number of authorized services happened well before the anti-piracy laws were passed. In fact, in many countries, the number of authorized services actually declined after the anti-piracy laws, likely as it became clear which platforms were the “winners” in that market, leading some of the lesser players to exit.

In the end, this research strongly suggests that if the industry is serious about increasing digital revenue and decreasing piracy, its efforts should shift away from pushing anti-piracy laws, and towards enabling and encouraging greater innovation in the form of new services.

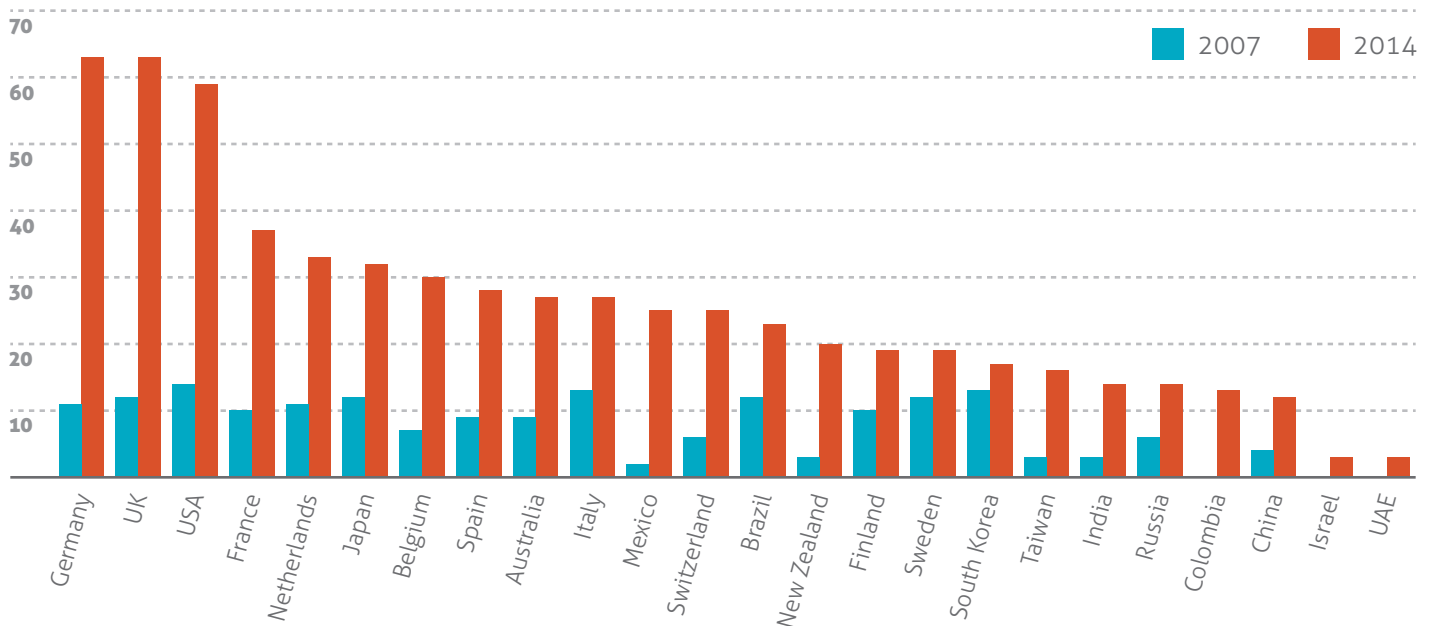
It's time to start offering more carrots and fewer sticks.

Data Overview

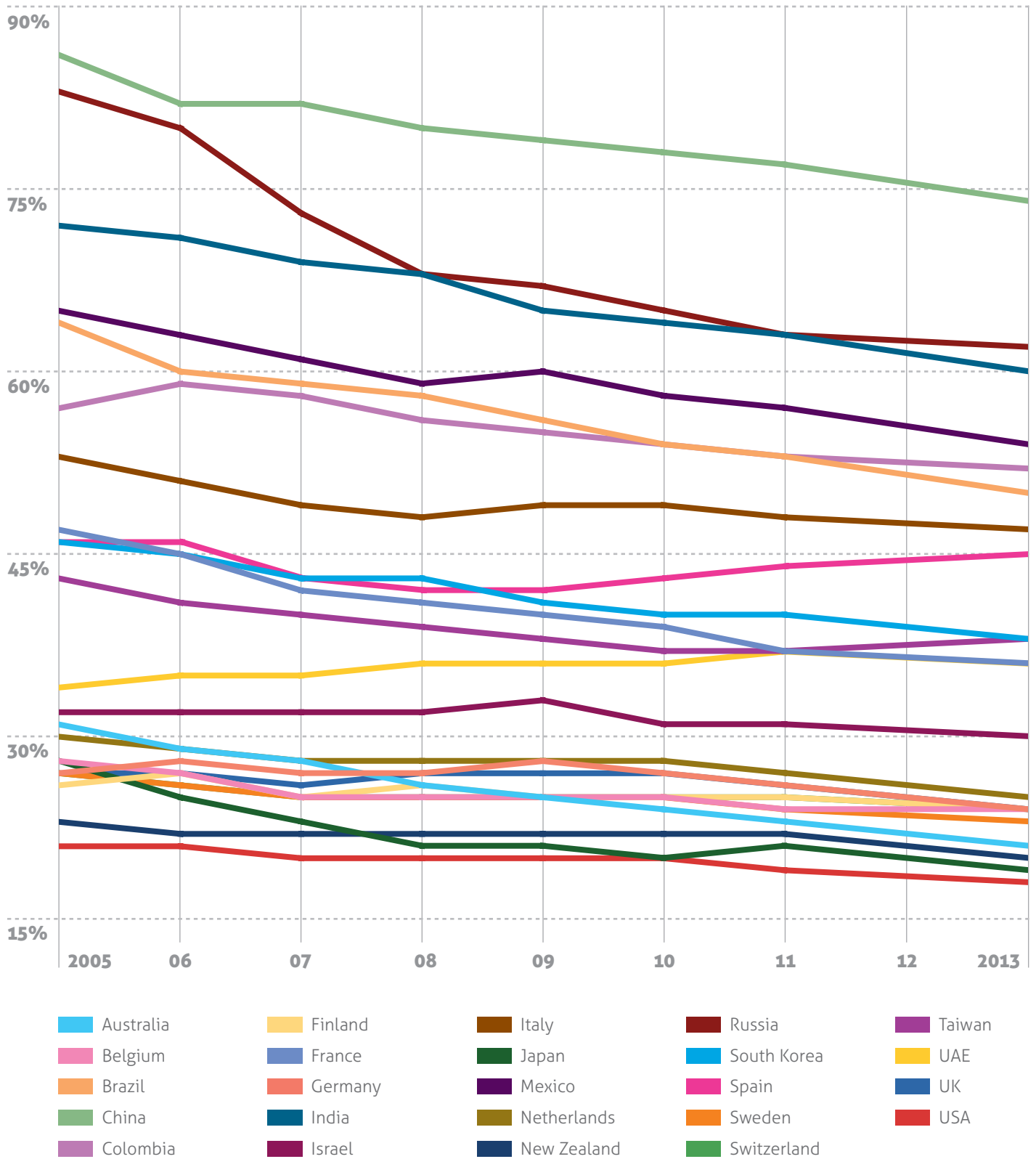
Worldwide, the scope of online piracy is difficult to quantify with reliable accuracy. In January 2013, an estimated 432 million unique internet users from all over the globe sought explicitly infringing materials, according to a NetNames report, and the putative trend for this population of internet users is constantly growing. The BSA (The Software Alliance) tracks piracy rates across more than 110 countries, but there are well-known weakness in its statistical measurements, and the BSA itself no longer reports piracy rates using its own decade-old methodology on an annual basis. Still, the BSA piracy trends for the largest countries are generally flat or declining over time. Government agencies as well as corporations also report piracy statistics such as the numbers of court actions, infringement notices and takedown requests. Unfortunately, all of these data points vary considerably in meaning and in context from country to country.

Given the piecemeal nature of information that can be collected on piracy, conclusions about the effectiveness of anti-piracy legislation efforts will need to rely on mounting evidence gathered from country to country. In lieu of randomized controlled trials, the natural experiment (or accidental experiments) to observe the behaviors of internet users across different legal environments can still provide insight into the efficacy of anti-piracy laws.

Number Of Legal Music Services 2007 VERSUS 2014, BY COUNTRY



BSA Piracy Rates BY COUNTRY, 2005-2013





France

THE LEGAL ENVIRONMENT

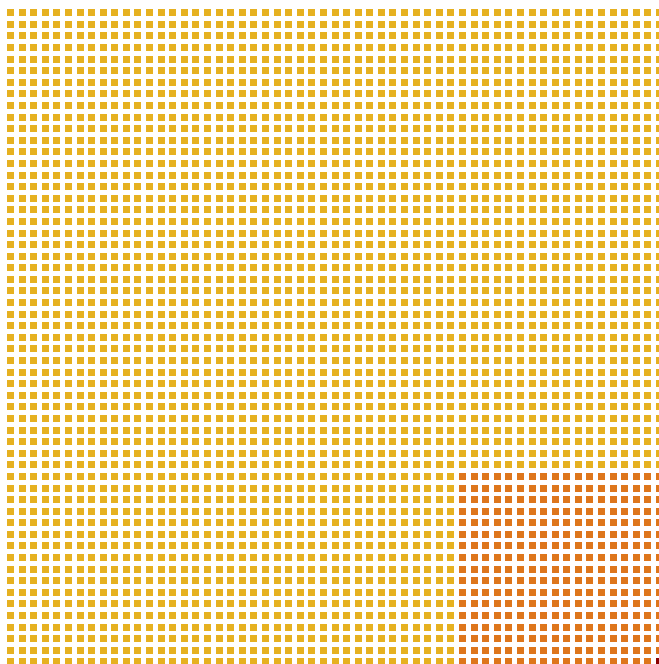
Over more than a hundred years, France has signed numerous international agreements to protect intellectual property rights, such as the Berne Convention, the Rome Convention, the Universal Copyright Convention of Geneva/Paris, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the WIPO Copyright treaty and the WIPO Performances and Phonograms Treaty, and several others. The Anti-Counterfeiting Trade Agreement (ACTA) was also signed but ultimately rejected by the European Parliament. Wave after wave of expanding copyright-related regulations

have been considered and enacted.

HADOPI Warnings

RECEIVED SINCE OCTOBER 2010

■ = Approx. 1,000 recipients



>3.2-million First Warnings

>300,000 Second Warnings

>1,000 Third & Final Warnings

On June 27, 2008, France implemented its IPRED (Intellectual Property Rights Enforcement Directive) to curtail counterfeiting and piracy, and legislation leading to HADOPI (Haute Autorité pour la Diffusion des Œuvres et la Protection des Droits sur Internet) continued for years. HADOPI ultimately went into effect at the beginning of 2010, and it created a new government agency to combat digital piracy. The HADOPI authority instituted a “graduated response” policy (also called a three strikes policy) that would issue three warnings to individuals suspected of pirating copyrighted files and then suspend internet access for up to a year if infringing activities continued.

Only a single internet service customer was sentenced to 15 days of suspended service and fined 600 euros, before the French Ministry of Culture published official decree No. 0157 on July 9, 2013 — removing the punishment of “suspension of access to a communication service” from the law and revising the monetary fines. Other people had been issued fines before this decree, and cumulatively, over 3.2 million people have received first warnings since October 2010. Over 300,000 received second warnings, and over a thou-

sand people have reached the third and final notification stage. The French government spent over 12 million euros annually and employed 60 agents to enforce HADOPI legislation, which French culture minister Aurélie Filippetti characterized as a failure to foster legal content and reduce illegal downloading.

Additionally, between 2010 and 2012, the Ministry of Culture ran a 'Youth Music Card' program to encourage music listeners who were 12-25 years old to purchase legal music online with matching public funding. The service had an annual budget of 14 million euros and included 14 online music service partners such as Amazon, iTunes, Deezer and FNAC. However, users were required to apply and obtain an identification code to redeem the offer, and the complexity of the system prevented it from catching on.

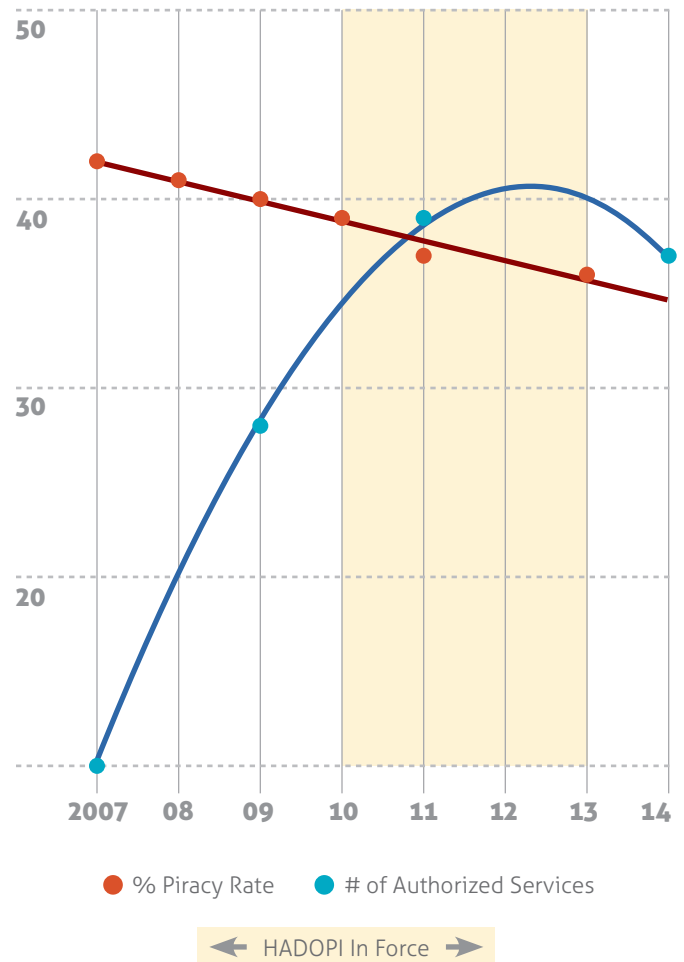
THE BUSINESS ENVIRONMENT

According to the Business Software Alliance (BSA), the software piracy rate in France is in a moderate range, comparable to countries like South Korea, Spain and Italy. Countries such as Mexico, China, India, and Russia have higher piracy rates, and Germany, Belgium, UK, Switzerland, Finland, the Netherlands, Sweden, Japan and the US have notably lower BSA-reported piracy rates. Following the general trend of BSA piracy rates, France's piracy rates have fallen from 47% in 2005 to 36% in 2013. This improvement is comparable to that of Mexico, Australia, India, South Korea and Japan. However, in the period after HADOPI was implemented, from 2011 to 2013, the BSA only saw a single percentage point drop in piracy rates, from 37% to 36%.

Several digital music services have launched and caught on quickly in France. Deezer started in 2007 with just three employees and took just three years to grow from a few thousand unique visitors to 12 million in France alone. The IFPI reported the number of digital music services nearly quadrupling from 10 in 2007 to 37 in 2014. However, music industry revenues in France have fallen from nearly \$1.5 billion in 2007 to \$956 million in 2013. In the time after HADOPI was imple-

Piracy & Legal Options

TRENDS IN THE FRENCH MUSIC INDUSTRY



mented, authorized music services in France actually dropped from 39 to 37 (though, 37 is still one of the largest numbers of licensed services in a single country — behind only Germany, the UK and the US).

In 2006, Apple threatened to remove iTunes from the French market, claiming that the DADVSI law was "state sponsored piracy" due to its requirement for songs sold on iTunes to be played on non-Apple devices. Ultimately, that compatibility requirement was removed, but Apple started selling DRM-free music in 2009.

HADOPI's effect on iTunes has been disputed. While initial research stating that the anti-piracy law promot-

ed more legal music purchases, subsequent analysis concluded that the benefits to legal music services were dubious because there were confounding factors that could not be isolated. Any increases in music revenues in France cannot directly be attributed to HADOPI due to the introduction of the iPhone, as well as the launch of popular streaming music services that could also have spurred more music purchases.

IMPACT

France, like other countries that passed controversial anti-piracy laws, hasn't seen a long-term boost to its overall media industry. Attributing additional sales to anti-piracy enforcement efforts is difficult to defend rigorously, and anti-piracy education campaigns have shown to be an ineffective strategy for boosting actual sales. Innovative music services were launched independently of laws concerning copyright, and France's largest music streaming service, Deezer, started years before the enforcement of HADOPI. Apple's iTunes service similarly was available for years prior to HADOPI. The fact that the number of authorized services actually declined by two after the introduction of HADOPI certainly suggests that music services did not need such a graduated response law to offer their services to the public.

From the data, it appears unlikely that HADOPI had any significant effect on piracy rates in France. Polls of French internet users show that about half of them still illegally download music and video files despite the law. A study done by Rebecca Giblin, exploring the impact of HADOPI on piracy rates in France, reviewed several reports that claimed that piracy rates reduced drastically in response to HADOPI, but noted that almost all failed to release their methodology publicly, or relied on questionable measurements. Furthermore, almost every one came from an industry organization who would benefit from claiming HADOPI reduced piracy.

Since 2013, HADOPI commissioned consumer surveys by Harris Interactive to rate the attractiveness of various legal media offerings, and music services are rated favorably along with software and games in terms of quality, ease of use and wide inventory variety. However, services offering legal films and TV series are rated as relatively unattractive by French consumers on these same criteria, and these media categories are more likely to be consumed via illegal methods in these polls. These survey results suggest that consumers are undeterred by piracy education campaigns and prefer convenience of service over the legality of offering.

The evidence strongly suggests that it is greater innovation, in the form of the introduction of new legal services and convenient distribution techniques, that drove the decrease in piracy rates, rather than legislative efforts.



Sweden

THE LEGAL ENVIRONMENT

In February 2009, the Swedish parliament voted on its IPRED (Intellectual Property Rights Enforcement Directive) legislation, and this law went into effect on April 1, 2009. The Swedish parliament was the first in Europe to pass a law implementing IPRED related to the directive previously passed by European Parliament. Sweden's IPRED law covered the remedies available to civil courts for intellectual property (IP) infringements. Criminal sanctions against IP violations are not part of IPRED, but informal proposals for a future "IPRED2" law were discussed to cover aspects of criminal enforcement.

A key provision of Sweden's IPRED enforcement allows for injunctions against intermediaries. For cases of file-sharing piracy, the internet service providers (ISPs) are the intermediaries involved in the prosecution of individuals accused of copyright infringement. Copyright holders have the right to obtain names and addresses of accused infringers from ISPs, and ISPs are obligated to reveal the personal information. As a result, the burden of work to pursue potential infringers has shifted to law enforcement when it had previously been the sole responsibility of rights-holders. In 2010, Swedish police and prosecutors created an anti-piracy task force aimed at file sharing and other intellectual property violations and increased the nation's resources for finding illicit file-sharers, at least where the evidence could be easily gathered since illicit file sharers increasingly use encryption and other tools to hide their activities.

The Swedish courts have been asked to rule on the legality of forcing ISPs to reveal personal information, and the EU Court of Justice has decided that it is reasonable for ISPs to reveal their customers' personal information under certain circumstances without violating EU privacy laws. Elsewhere in the Swedish legal system, the monetary fines for copyright infringement appear to be somewhat inconsistent, as one Swedish man was sentenced to a conditional 2 years in jail and fined 40 days of his income for sharing 2,880 music tracks while another file-sharer was charged with a 13,000 kronor fine (appealed up from 2,000 kronor) for sharing 44 songs. The Swedish public has responded to various legal incidents by creating a Pirate Party of Sweden, which gained over 50,000 members in 2009 to become the country's third largest political party. Other Swedish citizens have formed the Missionary Church of Kopimism, an officially recognized religion that wishes to preserve the right to copying information as a "sacred act" with religious freedom protections.

THE BUSINESS ENVIRONMENT

According to the Business Software Alliance (BSA), Sweden has a relatively low software piracy rate of 23% (2013) down from 27% in 2005. This BSA piracy rate is notably less than piracy rates in countries like Mexico (65%), China (74%), India (60%), and Russia (62%). Sweden is comparable to countries such as Germany (24%), Belgium (24%), UK (24%), Switzerland (24%), Finland (24%) and the Netherlands (25%), and Sweden isn't so different from the US which has a piracy rate of 18% (2013) down from 21% in 2005. Sweden's piracy rate is also quite a bit lower than that of France

(36%), South Korea (38%) and Spain (45%). This piracy metric hasn't changed drastically for Sweden over the last several years, but it's still trending downward, as most countries covered by BSA's piracy reports have experienced as well.

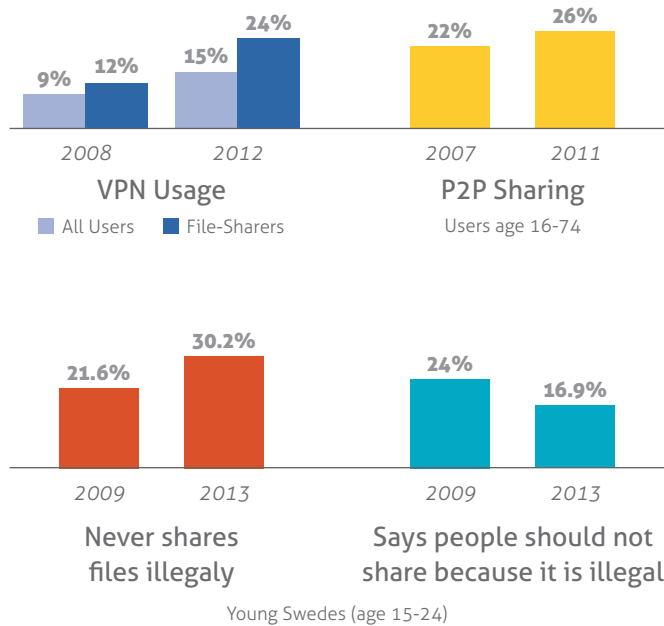
For music and movies, the metrics for piracy are not as clear cut. Simply monitoring the traffic of popular peer-to-peer (P2P) networks doesn't necessarily capture an accurate pulse of piracy since P2P users can adopt various technologies to hide their illicit activity by using encryption and virtual private networks (VPNs). Additionally, not all P2P traffic is infringing material. Some ISPs in Sweden have even taken protective steps for their customers' privacy by encrypting all traffic or deleting all their log files. In Sweden, VPNs were used by 9% of internet users and 12% of file-sharers in 2008, before IPRED was enacted. By 2012, VPN usage increased to 15% of internet users and 24% of file-sharers. A separate 2012 study from Lund University also found that 61% of 15 to 25-year-olds participated in sharing activ-

ities that violated copyright regulations, suggesting that file-sharers did not change their behavior due to IPRED. According to the Organization for Economic Cooperation and Development (OECD), P2P file-sharing for internet users, age 16-74, in Sweden increased from 22% in 2007 to 26% in 2011. In the year that IPRED was put into effect, internet traffic dropped massively, by 30%, following the introduction of the law in April, but just eight months later, internet traffic resumed pre-IPRED levels by November 2009.

Following IPRED, legal music downloads increased significantly — with reports that music download sales were up 100% in the weeks after the law took effect. According to the recording industry, legal music sales reversed a downward trend to grow by double digits in certain categories. Around the same timeframe, Spotify launched its legal P2P streaming service in 2008, offering access to 6 million songs (now over 20 million). This Swedish music service became quite popular, and according to the International Federation of the Phonographic Industry (IFPI), 89% of Spotify's paying users and about 70% of Spotify's free users downloaded illegally less often, and 47% of Sweden's internet users were using a music subscription service. In 2012, streaming music (dominated by Spotify) accounted for 89% of digital music sales in Sweden, and the rise of streaming music is credited by the IFPI for a corresponding increase in investment in new musicians. From 2008 to 2013, the IFPI reported music revenues in Sweden growing from \$144.8 million to \$194.2 million, and the number of legal music services increased from 12 in 2007 to 19 in 2014. A Lund University survey of 4,000 Swedes in the 15-24 year-old age bracket reported a significant decline in file-sharing, stating that the percentage of young people who never share files illegally increased from 21.6% to 30.2% from 2009 to 2013. According to the survey, the introduction of legal streaming services such as Spotify and Netflix caused the decrease in file-sharing activity, as the number of young Swedes who said people should not file share because it is illegal actually decreased from 24% to 16.9%.

Trends & Behaviors

AMONG SWEDISH INTERNET USERS



IMPACT

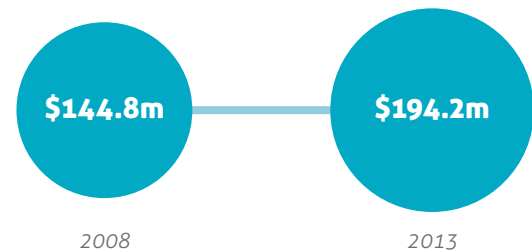
Sweden is a particularly notable country for studying the effects of regulation and innovation on digital piracy. Both The Pirate Bay (TPB) and Spotify originated in Sweden, giving Swedes the ability to consume digital content using several innovative methods — legal and illegal. The introduction of IPRED coincided with an apparently drastic reduction of music piracy, but on a short time scale, as the metric of measuring internet traffic showed a sudden drop but also an eventual rebound. So while the enactment of IPRED may have initially scared P2P file-sharers, the evidence of a long-term effect of IPRED to deter file-sharing is absent. Based on survey responses, the long-term decrease in illicit file-sharing is a result of the availability of convenient licensed services and not due to the threat of fines or law enforcement. P2P file-sharers who maintain illicit behavior presumably also employ technological solutions to hide their activities. However, another study from Sweden's Internet Infrastructure Foundation found that a larger fraction of file-sharers pay to download individual song tracks compared to non-file-sharers, so file-sharers are also paying customers for the music industry.

Beyond the evidence that file sharing rates rapidly returned to the earlier numbers after a brief dip following the introduction of IPRED, other numbers support the idea that it was the introduction of authorized services, rather than the legal change, that resulted in the decrease in infringement. As in France, despite applying equally to all forms of copyright-covered content, there is no noticeable change in the BSA piracy numbers for Sweden following the introduction of IPRED — which would be expected, if it were really scaring users away from infringement. Similarly, right after the implementation of IPRED, the unauthorized streaming of TV shows actually increased, according to a study done by Media-vision.

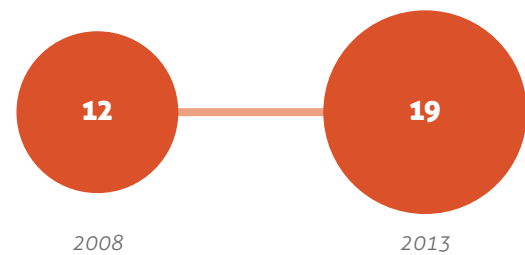
Instead, the decline in infringement in Sweden started with the rise of new authorized services, and clearly tracks to the timing of those services becoming successful. After the introduction of IPRED, it's clear that

Revenues & Services

IN THE SWEDISH MUSIC INDUSTRY



IFPI Music Revenues



Number of Legal Digital Music Services

the downloading of unauthorized music files decreased, but that was at the same time as Spotify began to take off in Sweden. And, while noted above that unauthorized TV show streaming increased after IPRED, it has since declined. Of course, the timing of that decline actually correlates quite closely to the 2012 introduction of Netflix in Sweden.

Finally, the idea that authorized services needed laws like IPRED to operate in Sweden again does not appear to be supported by the facts. Before IPRED was in place, there were 20 authorized services already available for music in Sweden. Soon after IPRED that number jumped to 27, but as of 2014, IFPI notes that the numbers are down to 19 authorized services — as many have exited the market, due to the clear dominance of Spotify.

Once again, the data strongly suggests that it was the rise of convenient, well-designed authorized services that drove down the piracy rates in Sweden, while major legal changes, such as IPRED, had little to no impact.



United Kingdom

THE LEGAL ENVIRONMENT

Under UK law, specifically the Copyright, Designs and Patents Act (CDPA, 1988), website owners found by the courts to be infringing copyright can be fined and/or imprisoned. Under Section 97A of CDPA, rights holders can also seek court injunctions against ISPs to require the blocking of access to infringing material. In 2006, peer-to-peer (P2P) file sharing was identified as a concern, and by 2008, the UK government encouraged several ISPs and rights holders to sign a Memorandum of Understanding to work together to improve awareness of the illegal nature of P2P file sharing. A voluntary scheme known as 'Creative Content UK' agreed to by the British Phonographic Industry (BPI), the Motion Picture Association (MPA) and the four largest UK internet service providers (ISPs) is set to begin in 2015. The Creative Content UK scheme will notify internet users of infringing behaviors and includes an educational campaign.

In May 2012, the UK High Court ordered 5 major ISPs to block The Pirate Bay website which reportedly had 3.7 million UK users at that time, and in October and November of 2013, the same ISPs were ordered to block 28 file sharing websites (9 music-only file sharing sites and 19 file sharing sites that provided infringing video content). An analysis of anonymized internet traffic data during these two events concluded that the block of The Pirate Bay website by itself had no effect on encouraging users to adopt legal content services, as users may have switched to alternative file sharing sites or used VPN (virtual private network) services to circumvent the block.

The larger court-ordered block in 2013, however, resulted in internet traffic patterns — from users with a previous history of file sharing usage — showing a modest 12% overall increase in clicks on legal video streaming sites such as Netflix. Not all file sharing users are equal, and the users who used file sharing networks more frequently appeared to also adopt legal channels more, but only up to a point. The heaviest file sharing users were found to be less likely than casual “pirates” to adopt legal offerings. There may be several possible explanations. Heavy file sharing users are generally more tech savvy internet users, and they could more readily circumvent website blocks. Legal offerings also compete with illegal pirate sites, and the heaviest users of file sharing sites may be accustomed to a wider and more attractive inventory of available content. A Kantar Media poll found that nearly 1 in 3 people in the UK (32%) who have infringed copyright online state that a greater availability of cheaper legal services would encourage them to stop infringing. Additionally, the comparative convenience between legal offerings and pirate sites might not yet favor the legal services for the most skilled pirates, as individual users have rarely been found to pirate content for a profit motive.

Even larger website blocking orders have been approved by UK courts, banning 93 websites across six major UK ISPs in late 2014. Critics continue to point out that website blocking can still be circumvented. Craig Melson of the Internet Service Providers Association (ISPA) responded to the court order, saying “The Internet Services Providers’ Association has long argued that web blocking is a relatively blunt tool. The entertainment industry should continue to adapt

its business models as consumption habits evolve with technology.” However, the 2014 arrest of a 20-year-old man who was charged with operating a proxy server to access piracy websites could serve as an additional deterrent for technical workarounds that circumvent website blocks.

The UK operates an independent enforcement unit called the Police Intellectual Property Crime Unit (PIPCU) established in September 2013 with £2.56 million in funding for two years, and it received another £3 million to fund the unit until 2017. The PIPCU aims to disrupt copyright infringing websites by notifying site owners, de-registering domain names and requesting advertising agencies to stop ad revenues to offending sites. The PIPCU’s Project Sunblock also replaces ads on copyright infringing websites with “official force banners” warning users that the site is under investigation for illegal activities and directing users to avoid using the site. The UK government expects spend £3.5 million over 3 years on the educational campaign for Creative Content UK with additional industry funding of £0.5 million. Estimates for the voluntary notification scheme, assuming 100,000 reports per month for the five major ISPs involved, are about £40 million over the first two years.

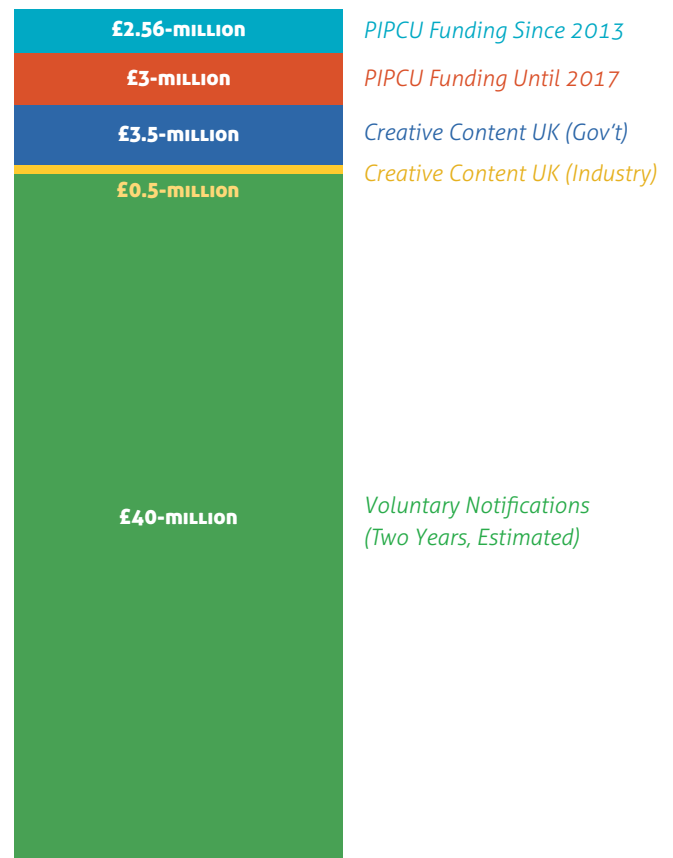
THE BUSINESS ENVIRONMENT

Software piracy rates in the UK are relatively low and have been gradually declining for the last decade. The BSA reports that the UK’s software piracy rates have fallen from 27% in 2005 to 24% by 2013. The UK’s piracy rates are comparable to countries such as Germany, Sweden, the Netherlands, Switzerland and Belgium. Only a handful of countries have lower piracy rates, such as the US, Japan, New Zealand and Australia.

In the UK, companies and organizations provide due diligence services for advertisers, ensuring that major brands and ad campaigns can avoid certain sites that host or facilitate access to infringing content online. The UK is not alone with ad services like this, services in Italy, France, Japan, Germany and the US also aim to

The Cost of Enforcement

MILLIONS SPENT TO FIGHT PIRACY IN THE UK



disrupt ad revenues to websites involved with copyright infringement and other non-intentional traffic. However, the online advertising business is a complex ecosystem that isn’t simple to police, but these services suggest there may be more market-driven approaches to curbing online piracy.

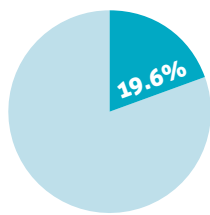
Consumers in the UK have access to a wide range of legal media services for music, movies, TV shows and other digital media. In fact, the UK is Europe’s largest market for MP3 players, digital music downloads, flat panel TVs and video games. According to the IFPI, 63 online music services were available in the UK in 2014, tied with Germany for the highest number of legal music offerings and ahead of the US with 59 music services. The UK had 70 legal music services in 2012, up

from just a dozen in 2007. Almost one in five (19.6%) UK consumers in 2012 preferred to buy all of their music in a digital format, and 27.7% of population has purchased legal digital music, according to BPI (British Phonographic Industry).

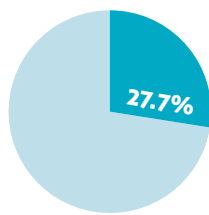
Several innovative music companies like Spotify weren't created in the UK, but these services are available to a growing number of UK listeners. Despite Spotify's success, the music service has hit some problems negotiating music licenses with rights holders, leading to periods of time when certain songs and artists are not available or may never be available to consumers — creating some consumer dissatisfaction. Spotify co-founder Daniel Ek has stated that his business is competing directly with piracy, and he believes he can offer an attractive legal service that can lure users away from illegal websites. According to Ek, "The ones we want to steal users from are the piracy services, that's our biggest competitor. Spotify could be something that works for movies, games or a lot of different things."

Legal Digital Services

IN THE UK ENTERTAINMENT INDUSTRIES

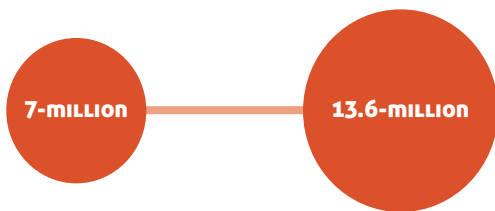


Prefers All Digital Music



Has Purchased Legal Digital Music

UK Consumer Survey, 2012



2014 2019 (Projected)
Digital Video On Demand Subscribers

Additionally, the subscription video on demand (SVoD) market in the UK is growing rapidly. Services from LoveFilm/Amazon, NowTV, Netflix, Apple and Google had over 7 million individual subscribers at the end of 2014 and are projected to grow to 13.6 million by 2019. Netflix CEO Reed Hastings has said multiple times that his company sees piracy as market research to determine what titles are popular and to offer a more compelling service that consumers want to buy.

IMPACT

The UK approach for anti-piracy enforcement appears to have had minimal effects on the nation's piracy behavior so far. Research from Ipsos estimates that nearly 30% of the UK population is actively engaged in some form of copyright infringement. Although the legal efforts to curb piracy seem to expand every year, the effectiveness of these campaigns is dubious, and an industry insider has reportedly admitted that, "It's not really going to divert or stop even medium-level or hardcore pirates. Maybe it will quash the nervous teenager, but that's about it." This sentiment seems to be borne out by the traffic data collected during the 2013 website blocking of 19 video file sharing sites, which suggests that the heaviest file sharing users are adept at circumventing website blocks.

The adoption of online subscription video services has been helped significantly by the rollout of fiber broadband networks which has improved the viewing experience for consumers. While the UK enforced website blocking orders, it notably has not targeted individuals with a graduated response policy. So in the absence of laws (eg. IPRED) that punish consumers for file sharing behavior, the UK still created a healthy market with one of the highest numbers of legal music and video services. This suggests that the innovation of media business models and providing valuable services can exist and thrive without laws that might restrict individual rights.



South Korea

THE LEGAL ENVIRONMENT

Since the Copyright Act of Korea was first established in 1957, there have been 14 amendments, two of which were total revisions — one in 1986 and another in 2006. Another revision of the law went into effect in 2007, which required internet service providers to filter content deemed illegal by rights holders on request. Then in July 2009, the South Korean government introduced graduated response measures (a “three strikes” copyright law) to crack down on online piracy. South Korea became the first country in the world to disconnect internet users under such a law, suspending the accounts of 11 internet users in November 2010.

Under South Korea’s three strikes law, users’ internet and online services accounts can be disconnected on order by the Korean Minister of Culture, Sport, and Tourism (MCST), who can require ISPs to suspend user accounts for up to 6 months after giving three warnings to remove supposedly infringing content. The Korean Copyright Commission (KCC) can also recommend that internet ISPs suspend certain user accounts for an undetermined period of time. However, it was reported that some people were getting disconnected after only one strike — likely due to the fact that almost all the ISPs acted on the KCC’s recommendations. In the year that the three strikes law went into effect, the KCC issued over 65,000 recommendations to Korean ISPs, which only declined to follow 40 recommendations to send out warning notices and 20 recommendations to delete certain content, and never declined to follow a recommendation to suspend an account. In comparison, the Korean Minister sent out only 275 warnings, 41 orders to delete content, and no orders to suspend accounts.

By early 2013, the Korean government had sent out almost half a million takedown notices and disconnected 408 user accounts, most of which were online storage services (known as ‘webhards’ or cyberlockers), disproportionately affecting far more users — most of them

Regulatory Timeline

CHANGING COPYRIGHT LAWS IN KOREA

- 2007** Copyright Act revised to require ISPs to filter content deemed illegal by rightsholders.
- 2009** Graduated response measures (“three strikes”) introduced. KCC issues over 65,000 recommendations to suspend user accounts.
- 2010** South Korea suspends 11 user accounts, becoming the first country in the world to disconnect internet users under a graduated response law.
- 2013** Korea’s National Human Rights Commission calls for re-examination and repeal of the three strikes law.

not engaging in large scale infringement — than the three strikes law was supposed to. In March 2013, Korea’s National Human Rights Commission recommended that the law be reexamined, questioning its regulatory effectiveness, and called for it to be repealed. Notably, Korea reportedly spends about 22 billion won (approx. \$20 million) per year on internet piracy enforcement — more than France — and encourages its citizens to report illegal websites with rewards worth roughly 3 million won (approx \$2,700) per year.

THE BUSINESS ENVIRONMENT

According to the Business Software Alliance (BSA), the software piracy rate in South Korea dropped from 46% in 2005 to 38% in 2013, following a downward trend similar to most other countries included in the BSA’s piracy reports. The percentage of Koreans who admitted to pirating software in 2011 was 69%, compared to 31% of Americans, and 57% of consumers worldwide.

In the first year after the three strikes law went into effect, the piracy rate went down, but only by 1%, from 41% (2009) to 40% (2010). However, based on the

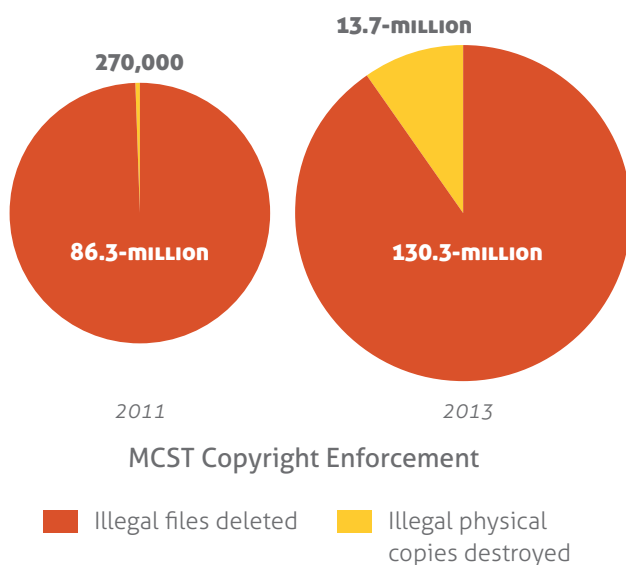
increasing number of allegedly illegal online files being deleted by the MCST and the increasing number of “corrective recommendations” being issued by the KCC in the years since, piracy in South Korea appears to be thriving despite the law. The number of illegal online files deleted by the MCST almost doubled from 2011 (86.3 million) to 2013 (130.3 million), and the number of illegal physical copies of music, videos, games, and publications destroyed in 2013 (~13.7 million) increased by more than 50 times the number destroyed in 2011 (~270,000). Meanwhile, the KCC issued 58.6% more corrective recommendations in 2013 compared to 2011.

As a result of the government’s strong infrastructural support, South Korea has not only the world’s fastest average internet connection speeds, but also one of the highest internet penetration rates (81%) in Asia, with more than 39 million internet users. The IFPI credits the 2009 three strikes law with encouraging the creation of more legitimate music services, reporting that the number of licensed music services in South Korea has increased from 13 in 2007 to 17 in 2014, and that in the year after the law took effect, music sales increased 12%. However, it isn’t clear that the new law actually led to the increase in music sales — and there’s now evidence indicating that these types of graduated response laws don’t work to stop piracy, as they simply push illegal file sharers to use alternative channels to access unlicensed content.

Compared to the rest of the world, South Korea has a unique music market. For example, while the rest of the world saw digital music sales go up and physical CD sales go down in 2012, South Korea’s physical revenue actually grew by 19% (its third successive year of growth), while its digital sales went down by 25%. South Korea was also the first major music market to become more than 50% digital in 2006, with 74% of digital revenues coming from subscription services in 2012. South Korea’s leading online music subscription service, MelOn, which now has more than 2 million paying users and 18 million registered users, started off by

Deletions & Destruction

UNDER KOREA’S COPYRIGHT LAW



charging reasonable subscriptions rates. Its revenues more than doubled between 2009 and 2012. However, in 2013, due to government intervention because of rights holder complaints, MelOn was pressured to double its subscription rate. Whether this will actually result in an increase in total subscription revenues remains to be seen. So far, reports have shown that since the mandated rate increase, online music sites have experienced a decrease in the number of subscriptions. When it comes to physical music revenues, unlike the rest of the world, South Korea's have been steadily growing since 2007. This appears to be due to the success of K-Pop not only in delivering unique physical products — such as fancy CD packages, complete with special limited edition merchandise — but also in creating extremely loyal fan bases that are willing to buy those products, which often results in fans buying more than one edition of the same release.

IMPACT

While online piracy is still significant in South Korea, music revenues have been steadily increasing back to what they used to be since their collapse in 2000-2005, due to a combination of competitively priced music subscription services, passionately loyal K-Pop fans, and smart physical and digital product marketing strategies.

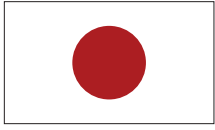
As in other countries, there is little to no evidence that South Korea's strict anti-piracy law in 2009 decreased piracy rates. Rebecca Giblin's research notes a strange lack of any data or evidence from anyone to support the claim that South Korea's three strikes law was a success. While IFPI and others have hailed it as a model example, there is a startling lack of data to support that — which is somewhat surprising if it truly is a model example.

Instead, the turnaround in fortunes for the music industry in South Korea clearly predates the law. The market hit its bottom in 2005, four years before the passage of the law, and there is little noticeable change in revenue in 2009 when the new law went into effect.

Similarly, when looking at the BSA data on piracy rates, it shows almost no decline at all following the passage of the three strikes law, staying basically steady until a slight decline in 2013, long after the law was passed.

As with other countries, there is little support to the idea that authorized services needed such a three strikes law to exist. In 2008, prior to the three strikes law, South Korea had 13 authorized services. Many did jump into the market in 2009, around the time the law went into effect, such that there were then 39 services, but by 2011, the number was back down to just 15 authorized services.

The government-mandated price increase seems only likely to push users back to unauthorized means of access, rather than these authorized services which have been so instrumental in the success of the Korean music market.



Japan

THE LEGAL ENVIRONMENT

In 1899, Japan enacted the first modern Japanese copyright law that was consistent with international standards of copyright protection. The Copyright Law of 1899 remained in effect for about 70 years, and went through several revisions and amendments, but was eventually replaced with a new copyright law in 1971. The new copyright law has also been revised many times since 1971, to keep up with technological developments, changes in socio-economic backgrounds, and international movements. In 2012, Japan passed a strict law that could include jail time (up to two years) and steep fines (up to 2 million yen) for downloading copyrighted material or backing up content from a DVD. The bill was approved by the Upper House of the Japanese Diet with a vote of 221 to 12, less than a week after it was approved by the lower house with almost no opposition. Until then, only people illegally uploading copyrighted content could be charged with criminal penalties of up to ten years in prison or up to 10 million yen. Opponents of the recent anti-piracy legislation have been concerned with the way the law is written, pointing out that it could lead to unnecessary prosecutions. In order to face charges, a violator needs to be aware that the material they're downloading is illegal. However, even an action like watching a YouTube video (with the knowledge that downloading it is illegal) could lead to people, including youths, being arrested.

THE BUSINESS ENVIRONMENT

According to the Business Software Alliance (BSA), the software piracy rate in Japan dropped from 28% in 2005 to 19% in 2013, following a downward trend similar to most other countries included in the BSA's piracy reports. The piracy rate in 2011 was 21%. After the anti-piracy law was passed in 2012, the piracy rate went down by 2%, to 19% in 2013. In the first year after the anti-piracy law went into effect, the number of people using the peer-to-peer file sharing programs Winny and Share (the two most popular programs used to illegally download content in Japan) dropped by 40%. Japan's Ministry of Internal Affairs and Communications, together with various film and music groups, even introduced decoy files — "copyright awareness" warning notices disguised as pirated content — on P2P networks, with the intention of scaring people away from illegally downloading files.

However, this didn't help CD sales, as they were even lower than they had been the previous year. Actually, CD sales initially went up by 5% from October 2012 to June 2013, but then the numbers from January 2013 to August 2013 showed a 7% decrease from the previous year. During this first year, no one was prosecuted for illegally downloading content under the new law either. While CD sales declined, the number of CD rentals increased by 50%. According to the Recording Industry Association of Japan, the law appeared to be effective in increasing CD rentals, but didn't seem to have an effect on the number of people who were actually buying music. The numbers appear to further support the

conclusion that there isn't a strong link between music piracy and declining CD sales.

Like those in South Korea, music fans in Japan seem to really like CDs, as they still account for about 85% of music sales in the country. In fact, Tower Records is still doing quite well in Japan. The music retailer's bankruptcy in the United States in 2006 didn't affect subsidiary Tower Records Japan (TRJ) as it had already become independent in 2002. TRJ currently has 85 directly operated retail stores in Japan, including one in Tokyo with 9 floors of store space totalling 5,000 square meters — one of the largest music retail stores in the world. The popularity of CDs in Japan may be a cultural thing. Greatest hits albums do really well there, possibly because of the artist-focused packaging, and artists have come up with clever ways to get people to buy multiple copies of an album. For example, popular girl group AKB48 pioneered the strategy of selling CDs that come with tickets that can be redeemed at live concerts where fans can meet members of the band. Other strategies include bundling merchandise with the CDs. Still, Japan's CD sales continue to decline, dropping 17% from 2013 to 2014.

Meanwhile, buying digital music and online streaming has been slow to catch on, but that's probably due to the Japanese music industry's reluctance to make it easy for consumers to buy music online or subscribe to streaming services. For example, while iTunes launched in Japan in 2005 (four years after it launched in the US), Sony Music Japan only allowed its song titles to be sold through iTunes in 2012. According to the IFPI, the number of licensed music services in Japan has increased from 12 to 32 from 2007 to 2014. The total streaming service revenue in Japan grew 204% from 2013 to 2014 — mostly due to the introduction of new domestic streaming services, since the large global streaming services like Spotify, Deezer, and Rdio haven't been able to reach agreements with the Japanese record industry to offer their services in Japan. Other popular streaming services that still aren't available in Japan include Pandora, iTunes Radio, Beats Radio, and Google Play Music.

CDs In Japan

STILL POPULAR, BUT DECLINING

85%

of Japanese music sales are CDs

85

Tower Records retail stores still operate in Japan

50%

increase in CD rentals from 2012 to 2013

17%

decline in CD sales from 2013 to 2014

Digital Music In Japan

GROWING, BUT SLOW TO CATCH ON

32

licensed music services operating in 2014

204%

growth in streaming revenue from 2013 to 2014

¥3.1-BILLION

revenue from subscription music services in 2013

The two main domestic streaming services are Sony Music Unlimited and RecoChoku. Sony's Music Unlimited was the first major streaming service to launch in Japan, and it's now the country's largest streaming service, offering more than 20 million songs from all major labels and leading independent labels. However, it still doesn't offer the most popular hits. But it does claim to have the highest conversion rate from trial to paid subscriptions of all 19 markets where it operates. RecoChoku is the leading digital music provider in Japan, and is backed by all the major music labels. In 2013, it

launched a smartphone-based streaming service called RecoChoku Best. However, what's interesting is that it appears that many people in Japan are using the RecoChoku app on their Nintendo 3DS to buy and listen to music — the app just recently reached 3 million downloads. The app allows users to buy from a selection of about 1 million songs, and it also acts as a music player. Downloaded songs can also be played as part of an alarm clock. The app also has a studio feature that allows users to practice singing and record songs. Due to the popularity of the app, RecoChoku has launched a new community feature for the app, aimed at helping users discover new music and making it easy for them to buy it later on.

IMPACT

There doesn't appear to be a clear link between piracy and music sales in Japan, since even after the strict anti-piracy law was enacted in 2012, CD sales have con-

tinued to decline, while CD rentals have increased. The availability of online music stores and streaming music services is still far behind what's available in the rest of the world, but it's starting to catch on. Just the few existing subscription music services in Japan generated 3.1 billion yen in revenue in 2013, a more than sixfold increase over the previous year.

As seen in other countries, despite the introduction of a strict anti-piracy law (which applies to software as well as music), the BSA numbers do not show a noticeable decline in piracy in Japan — which you would expect to see if the law was effective in reducing piracy.

The real issue in Japan, as noted above, appears to be the very slow embrace by the industry of legal and authorized services in Japan. It seems notable that revenue is only just now starting to increase, now that more authorized services have been allowed, and that this did not come in the period immediately following the introduction of the very strict anti-piracy regulations.

Once again it appears that encouraging innovation in the marketplace, rather than strict anti-piracy laws, is the strongest driver of new revenue and a way to decrease piracy rates.



New Zealand

THE LEGAL ENVIRONMENT

For the most part, New Zealand’s copyright law has been very similar to UK copyright law, except for a few differences that haven’t resulted in significant policy changes. New Zealand’s Copyright Act of 1913 was essentially the same as the United Kingdom Act of 1911, and the 1962 and 1994 New Zealand Acts were mostly based on the 1956 and 1988 UK Acts. New Zealand is also a party to a number of international copyright agreements, including the Berne Convention, the Universal Copyright Convention of 1952 and the TRIPS Agreement of 1994.

New Zealand enacted the Copyright (New Technologies) Amendment Act of 2008, updating its Copyright Act of 1994 to address the advances in digital technology. According to a study in 2008, conducted for the New Zealand Federation Against Copyright Theft, 70% of internet users (aged 15-30) said they would stop illegally uploading and downloading copyrighted movies if their ISP had the ability to suspend or terminate their internet accounts for breaking the law. In September 2011, New Zealand enacted the Copyright (Infringing File Sharing) Amendment Act, known informally as “Skynet,” which instituted a graduated response system that required ISPs to send warning notices to users suspected by copyright owners of infringement through peer-to-peer file sharing. After three warnings, copyright owners could take their case to the Copyright Tribunal (which consists of five intellectual property lawyers), which could fine users up to NZ\$15,000 for repeat infringement. Initially, the law also provided for users’ internet access to be suspended for up to six months if the three-strikes process didn’t work, but the law has been amended such that users can’t simply be disconnected for repeat infringement, but only by an Order in Council. In 2012, Telecom New Zealand stated that it had spent \$534,416 to issue just 1,238 notices, and notably, copyright holders are required to pay a NZ\$25 fee to issue notices. Placing part of the financial burden of enforcement on copyright holders is a requirement that other countries could consider, but this requirement in New Zealand has been debated — with telecommunications companies arguing for higher fees and copyright holders fighting for the fees to be cut significantly.

Since September 2014, the Copyright Tribunal has

Costs, Fees & Fines

UNDER “SKYNET” GRADUATED RESPONSE LAW

NZ\$15,000

Maximum fine for repeat infringement

NZ\$900

Highest fine issued to date

NZ\$534,416

Total spent by Telecom New Zealand to issue 1,238 notices

NZ\$25

Fee to copyright holders for issuing notices

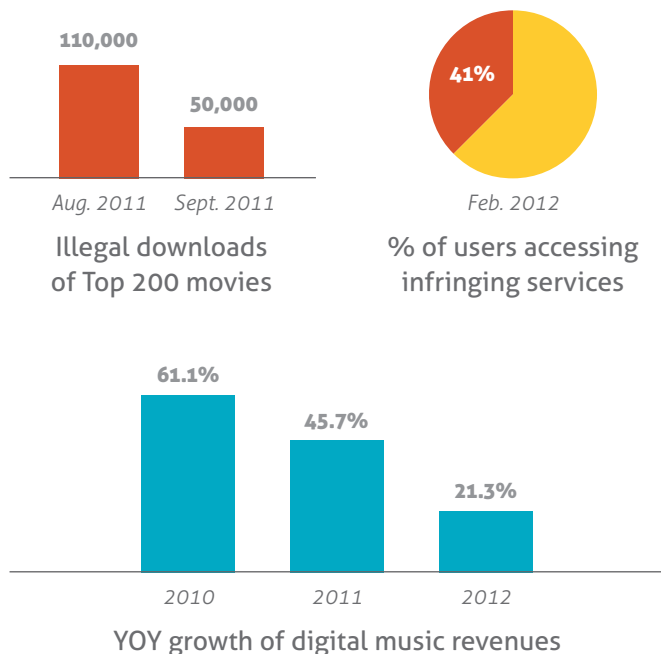
only ruled on 18 cases, with the highest amount that infringers have been fined being just over NZ\$900. The average time from filing to a decision is about 5 months. While the General Counsel of Recorded Music NZ (a non-profit trade association of record producers, distributors, and artists who sell music in New Zealand) decided to take a break from bringing cases before the Copyright Tribunal in December 2013 because it cost too much, took too long, and it felt that infringers weren't getting fined enough penalties, in late 2014, it decided to continue bringing more cases, claiming that music piracy was still a problem and it didn't have any other way to deal with it.

THE BUSINESS ENVIRONMENT

Following the enactment of the anti-piracy law, the number of times Top 200 movies were illegally downloaded was cut in half — dropping from 110,000 in August 2011 to around 50,000 in September 2011, when the law went into effect, according to the Federa-

Impact Of Three Strikes

UNCLEAR AND SHORT-LIVED



tion Against Copyright Theft (formed by the Motion Picture Association). However, from that point, piracy rates didn't change much, with 41% of internet users still accessing copyright infringing services online in February 2012. From October 2011 to April 2012, more than 2,700 warning notices were sent out, but only three users actually received a third notice. Furthermore, for reasons unknown, the Recording Industry Association of New Zealand never took the users to court and allowed the notices to expire.

The effect of New Zealand's anti-piracy law on music sales in 2012, a year after the law was enacted, also wasn't immediately apparent, as overall recorded music revenues continued to decline by 2.1%, which was about the same as the 1.9% drop in 2010, according to the IFPI's data. Additionally, in 2012, the country's digital revenue continued to grow by 21.3%, but not as much as in previous years: 61.1% in 2010, and 45.7% in 2011. A study by researchers at Northwestern University that looked at trends in user activity patterns to determine the impact of New Zealand's copyright law on user behavior found that heavy users of file-sharing sites significantly reduced their BitTorrent usage starting on August 11, 2011 — they initiated fewer downloads and were less likely to stay active for multiple days. Even though the law officially went into effect on September 1, a less-publicized part of the law allowed for infringements to start counting against users three weeks before, on August 11 — heavy users were more likely to know about this detail. In comparison, typical users continued to download content occasionally, but they were less likely to use BitTorrent on a regular basis. The study also looked at the impact of New Zealand's three strikes law on users' long-term download behavior. It found that two months later, user activity had increased back to the levels observed before the law went into effect. This was similar to what was seen in Sweden after an anti-piracy law was enacted there in 2009.

On June 25, 2014, New Zealand's Internet Party — founded by Kim Dotcom, also the founder of file-sharing sites Megaupload and Mega — proposed changes

to the country's copyright law in its draft Copyright and Open Research Policy. Seeing that copyright infringement is largely related to the lack of availability of legal content online, the Internet Party is working to increase the availability of such content, making it easier for people to access it instantly online at a reasonable cost.

IMPACT

Once again, in looking at the implementation of New Zealand's three strikes, and looking at the BSA's piracy numbers, we see little direct impact. There was a mod-

est decline of about 2%, which is at least notable as the software piracy rate in New Zealand had held steady for many years prior to that.

Perhaps more notable is that during this same period of time, some of the most famous authorized music services did launch in New Zealand, decreasing the need for New Zealanders to seek out unauthorized offerings. Spotify, Pandora, Google Play, Rdio, I Heart Radio and Deezer all entered the New Zealand market in just the past few years.

While New Zealand's anti-piracy law appeared to have a short-term effect on reducing file-sharing, activity quickly returned to previous levels within two months of the law being enacted.