



PROPOSED INCREASES TO PPCA MUSIC COPYRIGHT TARIFF

Briefing on pending litigation | 18 February 2009

1. Introduction

The fitness industry is facing an enormous threat to its financial viability with the move by major international record companies to place a 'value' on the public use of protected sound recordings in fitness facilities.

Australia is the test market for a new way of placing an economic valuation on music using choice modelling or consumer 'willingness to pay' modelling. The international record companies have initiated and implemented this strategy through the relevant copyright collecting society in Australia, the Phonographic Performance Company of Australia (PPCA).

The PPCA is authorised by the Australian Competition and Consumer Commission (ACCC) to issue a blanket license to collect copyright on the public performance of sound recordings. The copyright on the lyrics and composition is collected by the Australian Performing Right Association (APRA).

Mediated Negotiation

Fitness Australia entered into a mediated negotiation with the Phonographic Performance Company of Australia (PPCA) on Friday 30 January 2009 in relation to the PPCA proposal to change the licensing arrangements and increase the tariff rate for the copyright license that applies to the public performance of a protected sound recording within a fitness business. The negotiation was mediated by Mr Roger Gyles QC who is a former judge of the Federal Court of Australia and a former Royal Commissioner.

Unfortunately, the mediation process failed to reach a settlement between the parties.

The fundamental basis of the PPCA claim is as follows:

- PPCA seeks remuneration of \$4.54 per member per month and \$0.99 per visit for a casual attendee at a fitness centre.
- The definition of a fitness 'class' has been altered by PPCA to be a 'structured form of exercise conducted in a Fitness Centre, accompanied by sound recordings, which may or may not be directed by a fitness instructor'.

This matter will now be determined by the Copyright Tribunal in a hearing scheduled to begin on **16 March 2009** in Sydney. The Hearing is expected to run for up to 17 working days over a five week period.

2. Background

- 2.1 Since late 2005, the Phonographic Performance Company of Australia (PPCA) has been seeking a substantial increase to the Fitness Class Tariff (Tariff V). This is the tariff payable for the use of protected sound recordings in group exercise classes.
- 2.2 The current Fitness Class Tariff in Australia is \$0.968c per group exercise class with an annual capped maximum of \$2,654.
- 2.3 On 2 April 2008, PPCA's particulars of rate and licence scheme were lodged in the Copyright Tribunal. The proposed scheme represents a major change to the method of calculation of the tariff and a substantial increase to the amount payable by fitness centres for the use of protected sound recordings.
- 2.4 The scheme, formerly called the "Fitness Class Licence Scheme" is now being described as "The **Fitness Centre** Licence Scheme".
- 2.5 The proposed rate is set at \$4.54 per member per month, with \$0.99 pay per visit attendance by a casual attendee at a fitness centre.

3. Details of the scheme and rate

- 3.1 The scheme calculation method and per member per month rate captures all members, regardless of whether they attend fitness classes or not.
- 3.2 A fitness class is described as "a structured form of exercise conducted in a fitness centre, accompanied by sound recordings which may or may not be directed by a fitness instructor". This represents a major shift away from the current licence scheme to a new method of calculation that captures everyone using the facility.
- 3.3 The following types of classes (without limitation) are included:
 - Aerobics
 - Circuit
 - Dance
 - Cycle
 - Strength/resistance
 - Circuit
 - Hybrid
 - Boxing/combat
 - Flexibility/stretching/abdominal
 - Specialty
 - Aqua
 - Age/lifestage
- 3.4 The rate of \$4.54 per member per month has been derived using a theoretical economic study called a consumer choice modelling or 'willingness to pay' survey.
- 3.5 The rate has already been discounted for the proportionate use of 'unprotected' or PPCA royalty-free music in fitness centres.
- 3.6 The rate has already been discounted for the proportion of members who do not attend fitness classes (suggested by PPCA in their evidence as being 60% of all fitness centre members).
- 3.7 The economic bargaining model used by PPCA provides for equal value to be distributed to the three parties in the bargain over music licence fees. The

three parties are (i) the fitness centre owner (ii) APRA representing the writers and composers and (iii) PPCA representing the recording companies and performers.

- 3.8 Given 3.7, the rate of \$4.54 per member per month, if accepted by the Copyright Tribunal, is likely to also be claimed by APRA. This is the experience in the *Nightclubs and Hotels* case which preceded the fitness industry case.
- 3.9 The combination of these changes suggest that PPCA are seeking to broaden the scope of application for the proposed new tariff thereby encompassing the entire industry, even those businesses that don't offer group fitness classes as defined by the fitness industry, i.e structured exercise routines choreographed to music (playing in the foreground), with a set timetable and led by a fitness instructor.
- 3.10 Organisations such as Curves, Contours and Healthy Inspirations plus those businesses offering small group circuits and group personal training will be covered within this new tariff structure and definition of a fitness class.
- 3.11 The per member tariff structure provides PPCA with a greater level of protection against substitution with alternative sources of music since they will only accept an 'all or nothing' approach to the tariff license scheme i.e. if a business plays ONE TRACK of a protected sound recording at any time, it will be required to hold a PPCA licence and pay this per member tariff.

4. Quantum of proposed tariff increase

- 4.1 PPCA is seeking remuneration of \$4.54 per member per month and \$0.99 pay per visit by a casual attendee at a fitness centre.
- 4.2 This represents a vast increase in the current PPCA rate of \$0.968 per fitness class with an annual capped maximum of \$2,654. For example, a known independent fitness centre in western Sydney, currently pays \$1,400 per annum for this license. Under the new structure and rate, the annual cost will increase to \$174,336 (an increase of approximately 12,344%). This will increase to \$348,732 per annum with APRA seeking an equivalent rate.
- 4.3 PPCA maintains that the quantum of the proposed fee increase is based on a well-researched consumer willingness to pay (WTP) economic valuation model.
- 4.4 PPCA considers that the increased fee will be imposed across the whole industry and that a uniform increase in costs will be to some extent passed onto consumers. As they state that the consumer WTP for music in exercise classes is currently undervalued, they suggest that gym membership fees are also undervalued. They do not believe that an increase of this extent in the price of gym memberships will substantially affect membership sales.

5. Evidence submitted

A substantial amount of expert and lay evidence has been submitted by PPCA to support its claim and also by Fitness Australia in response. Fitness Australia has commissioned several expert economic and market research consultants to provide expert advice on the fitness industry case. The ACCC has submitted one affidavit as expert economic evidence.

Fitness Australia, on advice from its lawyers, Minter Ellison, has developed a strong economic counter-argument to the PPCA claim. The principal expert witnesses for Fitness Australia are Professor Hanemann from Berkeley

University (USA), Professor Krosnick from Stanford University (USA) and Dr Timothy Bock, a quantitative market research specialist based in Australia. The complexity of the case will require a significant amount of cross-examination in the Tribunal, where up to 28 witnesses are involved.

The Copyright Tribunal is increasingly reliant on economic argument in cases involving copyright license disputes. This has been borne out in two recent cases run by Minter Ellison where they represented (1) Foxtel (Pay TV) and (2) the Nightclubs and Hotels against the PPCA. In both these cases, the PPCA relied heavily on research and economic modelling to arrive at new tariff rates that vastly exceeded the existing rates. In the Foxtel case, the economic modelling survey was rejected by the Tribunal. However, in the Nightclubs case, it was accepted and a legal precedent has now been set.

The key strength of the fitness industry case relies on strong economic-based counter arguments that challenge the validity and reliability of the economic modelling survey being used by PPCA. Therefore, the need to heavily involve our expert witnesses in this case is a critical success factor for the case.

A win by PPCA will set a precedent that will have global implications for the fitness industry. If successful in this case, the major record companies will have created a 'value' on the use of music that is vastly inflated. This will enable them to use this model in other jurisdictions around the world.

The Collecting Societies for the copyright on lyrics and composition, will also expect, and demand, to receive their share of this 'value'. This is currently happening in Australia, where APRA is already applying the value of the new tariff in the Nightclubs industry.

It is for this reason that we must stop the record companies from proceeding further with this strategy in their test market in Australia. The only way to achieve this is to fight hard in the Tribunal and have the economic valuation modelling dismissed and rejected in the Court.

6. Fitness Australia's position

Fitness Australia's position on this matter has been guided by a combination of research, fitness industry consultation and feedback, legal and economic advice, and advice from music industry and public relations experts.

The key principles of Fitness Australia's position are as follows:

- 6.1 The PPCA tariff should remain as a 'per class tariff' and not be changed to a 'per member tariff'; however, other fair and reasonable tariff calculation methodologies are being considered in line with overseas jurisdictions;
- 6.2 The tariff should be negotiated on a commercial basis with the fitness industry, and not be set on the basis of a theoretical economic valuation modelling analysis;
- 6.3 The choice modelling survey used by PPCA is fundamentally flawed and inappropriate, resulting in a vastly inflated value for music in the fitness centre environment. These results should be disregarded by the Tribunal;
- 6.4 The fitness industry is able to access reliable and high quality music for use in its facilities that is not subject to PPCA license fees.

7. Music copyright information

7.1 It is important to note that fitness, leisure or recreation centres that play music in their facilities are legally obliged to hold a license from both the Australasian Performing Right Association (APRA) and the Phonographic Performance Company of Australia (PPCA). For more information on these organisations and the applicable license schemes and tariffs visit the following websites:

www.apra.com.au

www.pcca.com.au

7.2 There are two forms of copyright in every song:

- (i) For the public performance of music, paid primarily to the record producers, licensed and collected by the Phonographic Performance Company of Australia of (PPCA)
- (ii) For the lyrics and composition, paid primarily to the artist, licensed and collected by the Australasian Performing Right Association (APRA).

8. Common industry misconceptions and FAQs

Q. *"I use cover music, for group exercise classes, so why should I be concerned?"*

A. Cover music does fall outside the PPCA repertoire so under the CURRENT per class tariff structure this tariff can be avoided when using cover songs. However, the proposed PPCA tariff is calculated on a **per member** basis, not a per class basis as it has been to date. To avoid the proposed PPCA tariff you would have to play no music at all in your facility or play 100% "covers" or "sound-alike" recordings where the public performance rights are not assigned to the PPCA. This is not just limited to group exercise classes as the PPCA has changed the definition of an exercise class to include any form of structured exercise with or without an instructor. Also, using cover versions of music does not and cannot avoid the APRA licence.

Also, if you play **JUST ONE TRACK** of a protected sound recording in your facility, you are required to hold a PPCA licence.

Q. *"My business doesn't pay PPCA, only APRA, so why should I worry?"*

A. If you play music in your facility, you are legally obliged to hold a license from both PPCA and APRA. The PPCA license is a blanket licence scheme, authorised by the ACCC, that covers around 90% of available music repertoire. The only way to avoid a PPCA licence is to play no music or play 100% "covers" or "sound-alike" recordings where the public performance rights are not assigned to the PPCA.

To date, PPCA the has not done a very good job of educating its clients about copyright and its license scheme. Nor has it done a good job of auditing fitness centres and achieving compliance with the scheme. However, if successful in their claim, the PPCA will be financially very well equipped to collect the tariff from the entire industry in the future.

Q. *"I don't run group exercise classes or I intend to cut out classes, so why should this apply to me?"*

A. The proposed tariff is based on a PER MEMBER basis, so if you play music in your facility, you will be required to hold PPCA and APRA licences. This is essentially a TAX on the industry and its clients. The tariff rate proposed by PPCA at \$4.54 per member per month, has already been 'discounted' for members who don't attend exercise classes. Also, the definition of exercise classes has been changed in order to capture all members in the tariff.

Q. *"I don't think that I should contribute to Operation MUSIC to fight this because I can avoid the PPCA tariff so I'm alright".*

A. Firstly, as explained above, it is not all that easy to avoid the proposed PPCA licence scheme and tariff, since it encompasses all members and all facilities where music is played. Secondly, if PPCA are successful in their claim, this theoretical 'value' of music in a fitness setting is established in the Federal Court and becomes LAW. APRA will simply apply the same rate to their licence scheme and tariff once this is determined. This will double the cost to the industry.

Therefore, in this situation, the best defence is to ATTACK. That is why Fitness Australia is pursuing litigation – to fight for a commercially fair and reasonable licence scheme and tariff to apply to the use of music in fitness, leisure and recreation centres.

Q. *"I don't think that we should be spending all this money on lawyers".*

A. The litigation process is expensive and will potentially cost around \$2M to mount an effective case in the Copyright Tribunal. The case is extremely complex and so, requires top legal advisors who are specialists in intellectual property and copyright law. However, a substantial amount of the funds raised by Operation MUSIC have also used to employ a range of experts in market research design and analysis and expert economists who understand and can respond to the economic modelling commissioned by PPCA. It is these arguments that will hold weight in the Tribunal.

With the advice of these experts, Fitness Australia has been able to develop a strong counter-argument to the PPCA claims. It is imperative that we have the funds to bring these experts from the USA into the Tribunal proceedings in March 2009 to provide evidence and to help the Barrister with cross-examination of PPCA experts.

All this is being done to protect the fitness industry from the potential to bear unfair and unreasonable increases to music copyright licence fees. It is up to the entire industry to take responsibility for this effort.

Q. *"Why doesn't the government get involved in this issue? What is being done to raise awareness of the issue".*

A. Because the matter is before the Copyright Tribunal (which is part of the Federal Court), governments and politicians are constrained from taking action by the due legal process of the courts. Despite this, high level discussions about this issue have been held with several key Ministers and with the ACCC.

The media has taken interest in this issue at various times throughout the last 2-3 years. The issue has been reported several times in all the major daily newspapers as well as the Financial Review and BRW magazine. It has also been seen on breakfast TV (Sunrise) and heard on radio across the nation.

We anticipate that media interest in the issue will pick up just prior to the Tribunal Hearing as the media sense a 'good story' unfolding. Part of the Operation MUSIC funding has been invested in strategic public relations activity using expert consultants and advisors.

9. What the fitness industry can do to help

EASY

1. CONTRIBUTE, and
2. TELL YOUR INDUSTRY COLLEAGUES TO CONTRIBUTE

Right now Fitness Australia's focus is on preparing for the litigation proceedings in the Copyright Tribunal so we urgently need to raise funds to optimise the case and get the best possible result for the fitness industry.

You can contribute to Operation MUSIC via the website:
<http://www.operationmusic.org.au/join-the-fight.html>

An amount of \$1.00 per member per centre is a good guide for contributions, but any amount is most welcome and appreciated.

If you have already contributed we thank you for your proactive support. Please tell your industry colleagues to contribute their share to protect this great industry.

Lauretta Stace
Chief Executive Officer
18 February 2009