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THE PROPOSED RENTAL RIGHT
FOR VIDEO AND SOUND RECORDINGS

(Working Paper)



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Corporate Affairs
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Bureau de la
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prepared by

Howard P. Knopf

Policy Research, Analysis and Liaison Directorate
Bureau of Policy Coordination
Consumer and Corporate Affairs Canada

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Policy Analysis and Liaison Branch
Ottawa/Hull
K1A 0C9

FOREWORD

This study on the complex issue of rental rights for video and sound recordings was initially prepared primarily for internal government use. However, the issues are sufficiently important and as yet uncharted in Canada that the Department of Consumer and Corporate Affairs has decided to make the study available to interested members of the public.

While every effort has been made to ensure that the data presented is as reliable as possible, current restraints have precluded at this time the first hand gathering of data in the manner ideally required for a study of this nature.

It must also be emphasized that none of the views contained in this study necessarily reflect the official policy of the Department or of the present or any previous government. Accordingly, it must be considered strictly as a background paper for reference and information purposes only.

A handwritten signature in black ink, appearing to read 'T. Robinson', with a large, sweeping flourish extending from the end of the name.

Dr. T. Russell Robinson
Assistant Deputy Minister
Bureau of Policy Coordination

THE PROPOSED RENTAL RIGHT
FOR VIDEO AND SOUND RECORDINGS

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THE PROPOSED RENTAL RIGHT
FOR VIDEO AND SOUND RECORDINGS

EXECUTIVE SUMMARY

The Proposal

The federal government's White Paper on copyright revision, released May 2, 1984, proposed that a "rental right" be given to copyright owners of sound recordings, films, and videotapes. Such a right would give them the exclusive right to control or authorize the commercial rental of their works to the public. The right could, unless otherwise qualified, be used to collect royalties, prohibit rentals, and otherwise control exploitation of product with a rental market potential, subject only to such competition laws as may apply. Other categories of copyright owners could benefit by this right in the future by means of its extension by the Governor in Council. An example of such a group that might be included at a future date depending on economic and market factors would be owners of copyright in computer software programmes.

The following points include the principal arguments for and against a rental right which have been put forward to date. The rationale behind these statements is explained in the text.

Principal Arguments for the Proposal

1. Video

- . The present market is greatly distorted with artificially high sale prices being the only means by which copyright owners can share in rental revenues.

- . Potential purchasers are resisting these high prices and comparatively few purchases are made by actual consumers.
- . Retail purchasers are presently "subsidizing" retail renters by paying a surcharge on most titles which is imposed to compensate copyright owners for the rental use.
- . A rental right would shift part of the present "consumer surplus" back to the copyright owners, who would be encouraged to:
 - a) drastically lower sale prices,
 - b) make available a greater variety and quantity of titles with an earlier release date.
- . The present market encourages commercial piracy by dealers and individual unauthorized reproduction in the home.
- . A rental right could result in lower inventory costs to dealers, with better product availability and support from distributors.
- . A rental right could facilitate a dramatic expansion in the home video market, which could result in significant improvements in economies of scale in manufacturing costs, and thereby could result in lower prices to dealers and consumers.

- . A market could develop for specialized video productions not intended for theatrical release or major television release such as music video, "how-to", and "classical" titles.

Principal Arguments Against the Proposal

- . The proposal, if enacted, would effect a drastic change in personal property law in general and copyright law in particular for which there is no proven need.
- . Costs to consumers for rental of videocassettes could dramatically increase, and the availability of many titles for rental could decrease or disappear.
- . The proposal, if enacted, would benefit foreign interests almost entirely and could result in a major increase in the already high outflow of revenues in this sector.
- . The present independent retail rental industry could be substantially prejudiced by:
 - a) having to absorb part of royalty costs, either directly or indirectly, plus increased transaction costs, and
 - b) possible direct competition from the Hollywood producer/distributor network which now supplies them with product.
- . The proposal could encourage, if not even legalize, marketing practices which are now actually, or potentially, contrary to the Combines Investigation Act.

- . The promised benefits of the proposal have already been or are in the process of being realized through market forces alone.
- . A rental right is, in pith and substance, arguably much more closely related to property and civil rights than to copyright and may, therefore, be outside of the federal government's jurisdiction.

Intended Results

The purpose of this proposal as it relates to video material would be to:

- . Ensure proper stimulation and reward to producers and copyright owners by providing a legal mechanism for them to control and participate in rentals of their product.
- . Encourage the creation of a viable sales market for video cassettes.
- . Enable a rental market to continue, with a wider variety of product and early release patterns.

The purpose of the proposal as it relates to sound recordings might conceivably entail the same results as the above in certain circumstances such as the rental of compact discs. However, it would be aimed primarily and directly at stopping the rental of sound recordings for the purpose of their use in home taping.

THE PROPOSED RENTAL RIGHT
FOR VIDEO AND SOUND RECORDINGS

INTRODUCTION

The federal government has proposed in its White Paper on copyright revision, released May 2, 1984, that copyright owners of films, videocassettes, and sound recordings be given the exclusive right to rent these items to the public for commercial gain. This would be known as a "rental right".

Since the election of a new government on September 5, 1984, this proposal, along with others in the White Paper, cannot be considered as official government policy unless and until specifically adopted by Cabinet. This document has been prepared, accordingly, as a Departmental background paper for the information and reference purposes of all interested persons both within and outside the government of Canada. Its purpose is to fairly present in a brief manner the significant available data and arguments bearing on this complex issue. It is beyond the scope of this paper to evaluate these arguments, and no inferences should be drawn by the reader as to departmental views on the merits or demerits of specific points of view. Moreover, the limitations of this paper preclude a presentation of many of the rebuttal arguments which have been or could be put forward in response to specific points.

The following analysis outlines the main economic and legal arguments for and against this proposal. The issues involved in the videocassette industry are considerably more complex than those pertaining to sound recordings. Accordingly, the rental right for sound recordings is analyzed separately, except as noted from time to time in this study.

A considerable amount of the data and argument presented below is derived from American sources. This is partly deliberate since the Canadian and American home video markets are and will be closely intertwined for the foreseeable future. Moreover, the rental right issue has been the focus of major congressional attention for some time with a considerable amount of analysis resulting. Finally, the legal and economic infrastructure of the home video industry is very similar in the U.S.A. and Canada.

However, to a certain extent, this Department has had to rely on American sources for data and analysis since no significant amount of study or debate has occurred in Canada until now. The Department has been greatly assisted in the preparation of this study by data otherwise unavailable furnished by industry sources on the condition that their identity remain confidential. Data presented and secondary references are current to July of 1984, unless otherwise noted. The reader should be forewarned that data relating to videocassettes changes extremely quickly, and that the rapid evolution of the VCR and videocassette rental industries has made it all but impossible to achieve more than a "snap shot" perspective of it to date at any given time in its short history.

It should be noted that since July of 1984, the video rental bills in the U.S.A. have lost their momentum. As of March 25, 1985 neither the House nor the Senate video rental bills have been reintroduced in the current (99th) Congress, and there is no indication that they will be reintroduced in the immediate future. Consequently, no further Congressional hearings on the video rental bills are scheduled at this time. As noted below, the audio rental bills recently were passed into law in the U.S.A.

The author gratefully acknowledges the assistance of Patrice Lemyre in gathering data and preparing the Appendices. The useful input of Bruce Couchman, Johanne Daniel, and George Redling is also appreciated. Special thanks are due to Jim Keon for advice on certain mysteries of economics and numerous other very useful suggestions. Last, but certainly not least, thank you to Evelyn Carreon for patience and skill in preparing the manuscript.

BACKGROUND

Legal

Under Anglo-Canadian copyright and property law, the copyright in a work and the rights pertaining to the physical object which embodies the work are completely distinct.¹ Recent high English authority has established that a copyright owner cannot prevent a rental shop from renting a record (or presumably a videocassette) once purchased outright by the proprietor unless the proprietor is actively sanctioning and encouraging an illegal use by the customer, for example, by the provision of on-premises duplication facilities.² A similar case brought under present Canadian law would almost certainly have the same result.

Although there is no succinct "first sale doctrine" in Anglo-Canadian jurisprudence, as is found in American law, there is a strong underlying tradition, if not actual principle, in personal property law that a vendor of an object (i.e. a videocassette or a record) cannot restrain a purchaser from further "alienation" of the object by resale, rental, or any other means.³

The Canadian position appears to be that a transfer of the ownership of a physical thing in which copyright subsists gives to the purchaser the right to do with it

¹ Copinger and Skone James on Copyright, London, 1980, p. 531.

² CBS v. Ames Records and Tapes (1981), 2 W.L.R. 973.

³ Halsbury's Law of England, 4th Edition, Vol. 35, paragraph 1168. See also Consumers Distributing v. Seiko Time Canada, (1984) 10 D.L.R. (4th) 161 at 174 (S.C.C.). The theoretical position for patented articles is slightly different. See below, page 31.

whatever he pleases except the right to make copies or otherwise infringe copyright.⁴ Thus, it is now perfectly legal for a rental store to purchase copies of a video-cassette or sound recording and rent them to the public in Canada, provided there is no active inducement to use these copies illegally.

In the U.S.A., there is ensconced in S. 109(a) of the U.S. Copyright Act (1976) what is known as the "first sale" doctrine, which essentially provides explicit statutory clarification for the position outlined above:

"Sec. 109. LIMITATION ON EXCLUSIVE RIGHTS: EFFECT OF TRANSFER OF PARTICULAR COPY OR PHONORECORD

(a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord."

A similar provision had been included as S. 27 of the 1909 U.S. Act which, in turn, codified certain key cases.⁵ American law has also, to a greater or lesser extent from time to time, viewed restraints on alienation of personal property as a type of vertical integration with anti-trust implications (see below).

Attempts have been made in the U.S.A. to control or share in revenues from rentals to the public by avoiding the occurrence of a "first sale". In other words, dealers could

⁴ Fox, Canadian Law of Copyright, 1967, page 287.

⁵ See Henry Bill Publishing v. Smythe, 27 Fed. 914 (1886), and Harrison v. Maynard, 61 Fed. 689, (1894).

acquire pre-recorded video cassettes only through leases or other means which do not constitute ownership. However, these attempts have been abandoned due to practical and legal difficulties in enforcement resulting from the contractual issues being state law matters and the lack of privity of contract with retail dealers, who can easily "purchase" from one another or other third parties rather than the authorized distributor.⁶ While this type of contractual enforcement may not be completely impossible in the U.S.A. or Canada, the major producers and distributors do not wish to pursue it further in either Canada or the U.S.A. at this time and prefer the certainty, uniformity, and much lower cost of enforcement through copyright law.

Thus, in both Canada and the U.S.A. at the present time, the normal videocassette rental types of operation can flourish for all practical purposes without the consent of the copyright owner, provided the particular copies being rented are owned by the proprietor and the proprietor is not actively encouraging illegal use of the rented product.

The North American "Home Video" Market

The "home video" market in North America comprises mainly pre-recorded videocassettes (PRCs) which are either sold or rented to consumers. The various formats of video discs which can be played on machines not capable of recording have ceased to be of any major significance, as the price of full-featured videocassette recorders (VCRs) in the

⁶ See Independent News Co. v. Williams, 293 F.2d 510, 517 (3d C. 2. 1961); Burke and Van Heusen, Inc. v. Arrow Dry, Inc., 233 F. Supp. 881 (E.D. Pa. 1964), Beard, The Sale, Rental, and Reproduction of Motion Picture Videocassettes: Piracy or Privilege?, 15 New England Law Review 435, 463 (1980).

U.S.A. has fallen to below \$300.00 (U.S.), and in Canada to under \$500.00 (Canadian).

It is estimated that VCR penetration of households at the end of 1983 was 11% in the U.S.A. and 12% in Canada. This represents approximately 9 million and 800,000 units respectively.⁷ However, other estimates for recent Canadian VCR penetration are as low as 8% for September 1983.⁸ Current estimates are much higher. See Appendices I, II, and III.

It is estimated that by 1990, the penetration rate of VCRs in American households will be almost 50% (40,000,000).⁹ A similar penetration rate can be assumed for Canada.

Since home VCR sales passed the cumulative total of one million units in the U.S.A. in 1979, the growth in sales has been virtually exponential, as has the controversy associated with them. Virtually every participant in the film production, distribution, exhibition, broadcasting, pay television, hardware and tape industries, and the retail sector has been attempting to analyze the implications of this penetration.

While it is utterly beyond the scope of this paper to analyze all of the available data and issues, a few relevant statistics will be mentioned briefly:

⁷ The Prerecorded Home Entertainment Industry, Eberstadt and Co. Inc., December 14, 1983, page 40.

⁸ CROP Bulletin, 83-5-21.

⁹ Videocassette Recorders and the Law of Copyright, Motion Pictures Associate of America, 1982, page 9.

- . Of total revenues from "theatrical" product in 1983 in the U.S.A., it is estimated that 13%-14% were from home video, and 10% from Pay TV. Both Pay TV and home video will likely continue to gain market share, with market share from box office and network television falling.¹⁰
- . It is estimated that the share of revenue from home video may rise to as much as 20% of total revenues in the next three years¹¹ with more conservative estimates of 16%.¹²
- . Total retail revenues for video software in the U.S.A. for 1983 were approximately \$1 billion¹³ and approximately \$150,000,000 in Canada.¹⁴
- . Vigorous competition is occurring between Pay TV and the home video market. Both sectors are involved in marketing of a similar product (i.e. recently released feature films) to consumers who wish to see them at home on a television set and are prepared to pay for so doing. While no conclusive studies are available, reliable industry spokespersons claim that home video has effectively curtailed the growth of Pay TV in the U.S.A. and may be a serious threat to the very

¹⁰ Goldman Sachs, page 2, Table 1, Wertheim & Co., as reported in New York Times, May 7, 1984.

¹¹ Film Canada Center, February 1984 issue #14.

¹² Goldman Sachs, page 2, Table 1. See Appendix VI.

¹³ Eberstadt, op. cit., page 23.

¹⁴ (according to industry sources)

existence of Pay TV in Canada. This point will be amplified below.

- . Of retail revenues estimated for 1984 in the U.S.A. from home video PRC sales and rentals, gross profits of \$1.2 billion will be earned by retailers and gross profits of \$330,000,000 will be earned by program owners, a ratio of almost 4:1. Projections to 1987 indicate that in a rental dominated market, retailers would earn gross profits of 3.3 billion, and program owners 980 million. In a sales dominated market in 1987, it is estimated that retailers would earn gross profits of 2.6 billion and program owners would earn gross profits of \$1.2 billion. See Appendix IV.¹⁵
- . There are currently estimated to be between 10,000-12,000 video software retailers in the U.S.A.¹⁶ and about 2,500 such retailers in Canada.
- . The median gross revenue of video software retailers in the U.S.A. in 1983 was \$91,500.¹⁷

¹⁵ Fairfield Group Study, as reported in Videonews, March 30, 1984.

¹⁶ Per A.C. Nielsen, Variety, 83/09/07 and UCLA study. See Appendix VI.

¹⁷ A.C. Nielson Study as reported in Variety, 83/09/07 (page 38). The corresponding figure for Canadian retailers is not available but is believed to be lower, based upon estimates of the number of retailers and the gross retail sales figures of the sector.

- . Rental transactions outnumber sale transactions at retail by 20:1 or more, although the current revenue split is approximately 77%-23%.¹⁸
- . A recently released study by A.C. Nielsen of New York¹⁹ indicates that a dramatic increase in rental and purchase of PRCs by VCR owners seems to be occurring. Seventy-five percent of such owners now purchase or rent PRCs, compared to just over 50% in 1982. In May 1982, 49% of owners rented cassettes while 70% did so at the end of 1983. Twenty-four percent of owners had purchased a cassette in the 12 months preceding the study. The study indicates that an average VCR household now rents five titles per month.

The Canadian Market

Generally speaking, the above data holds true for the Canadian market. However, some particular points should be noted with respect to Canada:

- . Only three of the major "Hollywood" distributors have distribution facilities in Canada. The other three majors process their orders by Canadian wholesalers through U.S.A. facilities.
- . Virtually no blank tapes are currently manufactured in Canada.

¹⁸ A.C. Nielsen Survey, as reported in Variety, July 9, 1983.

¹⁹ Done in November and December 1983 and January 1984 as reported in Billboard, May 12, 1984, page 3.

- . Manufacturing costs of PRCs are significantly greater in Canada, principally due to duty, federal sales tax on blank tapes in certain situations such as where the distributor does not have a Canadian operation, exchange rates, and less economies of scale in duplication, according to industry spokesmen. While average manufacturing costs in the U.S.A. are approximately \$13.00 (U.S.), the comparable figure in Canada is \$20.00 (Canadian), according to these spokesmen. These figures include certain costs above laboratory and tape costs alone (i.e. the duplicating cost).
- . Total sales in Canada of a major title by a distributor are considered satisfactory at the range of 10,000 to 15,000 copies, while the comparable figure for the U.S.A. is 70,000-80,000 copies.
- . The functional structure of the distribution system in Canada for the major Hollywood distributors is set out in chart form in Appendix VII.

The Present U.S.A. Legislative Environment

There have recently been several bills before Congress potentially affecting the video and audio industries. The most important of these, and the ones receiving most attention, are H.R. 1027 and H.R. 1029, and the parallel bills in the Senate, S. 32 and S. 33. The record rental bills have now become law (H.R. 5938 and S. 32, P.L. 98-450). These bills would, essentially, modify or repeal (depending on the viewpoint of the commentator) the first

sale doctrine as it applies to video and audio recordings. The principal proponent of the bills is the MPAA (Motion Picture Association of America) which represents the major "Hollywood" studios and distributors. The principal opponents are the Home Recording Rights Coalition (HRRRC) and the Video Software Dealers Association (VSDA). After the U.S. Supreme Court ruled against the Hollywood studios on the home taping issue,²⁰ lobbying attention and congressional momentum shifted to the rental bills. There were indications that certain proposed amendments might have achieved some momentum and might have facilitated passage of those bills. These include:

- . An antitrust provision to clarify that the bills would not affect existing antitrust law.
- . A simultaneous rental and sale guarantee to assure dealers that studios would not hold back certain product for rental.
- . A "sunset" provision which would limit its effect to perhaps five years, unless extended by Congress after further study of its effects.
- . An exemption for existing store inventory and perhaps all titles issued prior to passage of the bill.

As of March 25, 1985, the video rental bills have not been reintroduced in the current (99th) Congress and the momentum for their passage seems to have been lost.²¹

²⁰ Universal v. Sony, (1984) 220 USPQ 665.

²¹ See above, page 2.

The implications of passage of such measures in the U.S.A. on Canada will be discussed below.

ARGUMENTS FOR A RENTAL RIGHT FOR VIDEO RECORDINGS

The following are the main arguments in support of the proposed right. Many of these points, as well as those in opposition (see below), have been raised primarily in the context of the proposed U.S. legislation. Such points have been considered by the Department only insofar as deemed relevant to the Canadian context.

The Distorted Market

The present system arguably effectively precludes control of the rental market or a sharing of its revenues on a per transaction basis or any other controllable basis by copyright owners. However, these owners, by their own admission, are currently using a "surcharge" system to, in effect, capitalize this rental revenue at the time of sale of the PRC to a retailer.²² This results in a member of the public who wishes to purchase being forced to pay typically \$79.95 (U.S.) (SLP) for a PRC which otherwise might be sold for \$29.95 (U.S.) (SLP). "SLP" refers to "suggested list price". The comparable figures for Canada might be \$89.95 (Canadian) and \$39.95 (Canadian). The lower figures are based on industry estimates of retail "sell-through" prices of typical product in the event that a rental right were to be enacted.

In effect, purchasers are arguably subsidizing renters of PRCs. Moreover, the owners of the PRC rights are arguably earning economic "rent" (that is considerably more profit than required to induce a given level of output) on the sale of each cassette to the rental dealer in order to

²² Testimony of Stephen Roberts, President, Twentieth Century Fox Telecommunications, April 29, 1983, before U.S. Senate Subcommittee.

capitalize in advance a portion of the revenue which the rental dealer will earn. The member of the public who rents at \$2.00 or \$3.00 per transaction is enjoying a "surplus" in economic terms if he or she is paying less to rent than they would otherwise be willing.

A recent pricing survey sponsored by Twentieth Century Fox Video, a synopsis of which was submitted to the Congressional Committees, concluded that a lowering of purchase prices to consumers from \$50.00 to \$30.00 would dramatically increase purchase dollar volume and transactions with only a very slight decrease in rental volume, assuming a constant rental price.

Twentieth Century Fox has proposed two scenarios for implementation of a rental right, both of which, according to Chairman of the Board Alan Hirschfield, would result in:

- a) stable rental prices,
- b) sale prices reduced up to 50%.

These are as follows and were proposed as alternatives and not on a mutually exclusive basis.²³

In the first, certain dealers would opt to pay a percentage royalty per rental, with PRCs intended for rental being dealt with on a "consignment" basis. A separate line would be available for direct "sell through" to consumers. This would reduce inventory cost to retailers, and would be most suitable to those with adequate computer facilities.

²³ Hirschfield Testimony re H.R. 1029, October 27, 1983.

The second scenario would be available to dealers who chose to use it. Simply, the dealer would purchase two types of PRCs. One would be marked for "sale only" and would cost about 50% less than today's wholesale prices. The other would be marked for "rental only" and have a surcharge factor built in, much as in today's market. This alternative does not require any increase in transaction costs and would be very simple to operate.

Another management model study has examined various alternatives of implementation of a rental right.²⁴ In one of the many scenarios outlined, the study concluded that the imposition of rental royalties would result in a temporary increase in rental prices, followed by a decline arising out of retail competition.²⁵

Thus, according to this argument, the establishment of a rental right would enable producers to "sell through" directly to consumers the PRCs which consumers choose to purchase at much lower prices than those normally in effect under the current surcharge system, while having an enforceable mechanism to share actual consumer rental revenue with retailers.

Shift of Consumer Surplus

In economic terms, a "consumer surplus" is said to exist when a commodity is bought by a consumer at a price which is less than the consumer is willing to pay. The UCLA

²⁴ "First Sale" and the Prerecorded Videocassette Industry, E. Asarnow, E. Ellenbogen, V. Gallow, B. Lepler, UCLA Graduate School of Management Thesis, unpublished, June 1983.

²⁵ Ibid, page ii and page 37.

study suggests²⁶ that (based upon an industry pricing study), consumer demand for rental is relatively inelastic between \$2.00 and \$5.00. This means that the quantity of transactions will decrease less in percentage than the percentage increase in price between these two price points. All available data indicates that average or normal rental prices per day currently in effect in North America are considerably less than \$5.00. In Canada, an "average" figure would be approximately \$2.50 to \$3.50 per night, with an additional \$1.00 average cost on weekends and as low as 99¢ per night on weeknights. Various rental marketing schemes such as movies combined with a machine or mandatory club memberships make a reliable average figure almost impossible to determine. Thus, there is little doubt that many consumers who rent videocassettes currently enjoy a "surplus" of about 50¢ to \$4.00 per transaction.

If rental prices were to increase, either because of a "royalty" which is largely passed onto consumers, or because of a lessening of supply by distributors, or for any other reason attributable to the advent of a "rental right", the surplus would be in part or in whole "removed" from the consumer and shifted to a higher point in the distribution chain. Most evidence suggests that it would shift to the producer/distributor, partly at the expense of the consumer and partly at the expense of the rental retailer.²⁷

In fact, the exercise of most rights in copyright involve a partial shift of consumer surplus in favour of copyright holders. For example, the actual copyright payments for mechanical rights involved in a typical long play-

²⁶ Ibid, page 33.

²⁷ See Fairfield study excerpt, Appendix IV.

ing record are currently 24¢ in Canada and 48¢ in the U.S.A. They comprise, at most, about 5% of the retail cost of the record. When the rates rose substantially in the U.S.A. from 2-3/4¢ to 4¢ per selection after 1976, there was no demonstrated resulting drop in quantity of record sales or profits to any sector involved in the production of recordings.

The theoretical advantage of such a shift of surplus for the consumer is the greater incentive for the producer of the product to make more varied and better product available in greater quantities. The result would be greater selection and convenience for the consumer.

In theory, natural competitive forces might well ensure that the surplus could shift from retailers to producers without a rise in consumer prices. This is one of the scenarios implied in the UCLA study²⁸ and by many industry spokesmen, and is based upon an assumption of lower sales prices to retailers resulting from the imposition of a rental right.

Lessening of Piracy and Home Taping

Piracy is considered to be the illegal or unauthorized reproduction of copyright material for commercial purposes. While reliable statistics are impossible to obtain (since pirates generally do not keep records or volunteer statistics on this type of activity), it is presumed by industry sources that many retail rental operations are actively renting or selling pirated copies of feature films. There are two main reasons for this phenomenon:

²⁸ See UCLA, op. cit., page 37.

1. The title has not yet been released by the distributor in PRC format. Such incidences usually occur with "blockbuster" titles, in which case the PRC release may be timed substantially longer than usual after the theatrical release.
2. The dealer wishes to avoid carrying inventory for rental at the high current "surcharged" prices.

A rental right is unlikely to have any effect on the first of the above situations directly, although it could have indirect effects. If the rental right proves very lucrative to the distributor, normal distribution "windows" or timing decisions could be altered to make legitimate product available sooner.

The second incentive to piracy might be considerably lessened by the establishment of a rental right. Inventory costs to dealers could fall substantially, especially those of "sale" product. If the rental product is handled on a royalty or license basis, it may be that no significant cash outlay would be required by the dealer for this inventory.

Home taping is now legal for the limited purpose of "time shifting" in the U.S.A.,²⁹ although probably not for the purpose of most other types of home taping such as the copying of PRC material. Home taping of copyright material for most purposes is and may or may not continue to be illegal under Canadian copyright law, depending on the final determination and interpretation of the "fair use" provisions in a revised Copyright Act. As long as sale prices remain very high, the consumer has a strong motivation to

²⁹ See Univeral v. Sony, (1984) 220 USPQ 665.

make unauthorized copies, especially of "collectable" material. This can be done in several ways:

1. Cooperation with a friend who has rented or bought a copy of the PRC.
2. By the consumer himself. This requires two VCR units. Ownership of two VCR units is becoming more prevalent as prices fall, and VCR units can now be rented on a nightly basis for less than \$10.00 including one or more PRCs.
3. By taping major commercial-free titles from Pay TV.
4. By taping older titles (often edited and with commercials) from regular broadcast television.

Such home-taping does have cost factors to the consumer. The blank tape must be purchased at a cost of typically \$10.00 retail in Canada. The resulting product has at least one more generation of quality degradation, if copied from a PRC and the quality of copies from Pay or regular broadcast TV is considered inferior in relation to commercial PRCs. There is also a time and inconvenience factor. If, as is widely predicted by proponents of a rental right, the sale price of "collectable" PRCs should fall to \$29.95 (U.S.), then the incentive for home taping of these titles would be considerably lessened.

Lower Inventory Costs to Retailers

As noted elsewhere in the paper,³⁰ the argument has been made that under certain scenarios, a rental right could result in lower inventory costs to dealers and thereby higher profits to them, other factors remaining equal.

Industry spokesmen from the distribution sector also note that many dealers are suffering from high inventory costs, especially so when interest rates are high, and that the retail rental sector is thus unstable. It is argued that the lowering of inventory costs would help to stabilize the cash flow of marginal rental operations. Proponents of the rental right in the U.S.A. claim that over 14,000 dealers have gone out of business as a result of increasing capital costs associated with maintaining an adequate prerecorded cassette inventory.

Lowering of Costs by Increased Economies of Scale

At the present time, the duplicating cost alone of a PRC is not lower than \$9.00 (U.S.) in the U.S.A. and \$15-\$17 (Canadian) in Canada, even in large quantities, according to industry spokesmen. For greater economies of scale to occur, a threshold in overall sales must be passed in order to lower two of the main variable cost components in this process which are blank tape costs and the wage and operation costs of duplicating machinery.

In Canada, blank tape costs are much higher because they are virtually all imported and subject to duty. There is insufficient demand at present to justify the building of

³⁰ page 19.

adequate blank tape manufacturing facilities here. Industry spokesmen have indicated that the increased sales of PRCs expected to result from a rental right might justify the establishment of such an operation.

Another problem facing distributors in both the U.S.A. and Canada is that of the current duplicating technology. At the present time, all tapes must be duplicated in "real time", i.e. it takes two hours to make a two-hour PRC.

Equipment is now available which can duplicate "Beta" format PRCs at up to 80 times faster than real time, with considerably more automation and a saving on blank tape costs. The newer systems use only as much tape as needed, and are not confined to standard lengths such as 120 minutes. However, this equipment is very costly and will not be economical with present sales levels.

However, at greater sales levels, the equipment could result in considerable savings and the price of the high-speed equipment would, in turn, fall as more of it is sold.

By analogy, prerecorded audio cassettes at one time were more expensive to make than long-playing records and considerably inferior in quality. Today, these cassettes are actually less expensive to make and audio quality is considered almost comparable to long playing records, with physical quality control being superior. This has resulted from vastly improved duplicating technology and economies of scale, as audio cassette sales have grown to equal conventional LP sales.

Specialized PRC-Only Markets

There is an emerging phenomenon of PRC titles aimed primarily, if not exclusively, at sales to consumers. These are titles which may never be shown on Pay TV or broadcast television, or in theatres. Examples include exercise and "how to" titles. It is argued that the prices for this product are currently artificially high for the same reasons as other product, i.e. the "surcharge" approach by the distributors. However, it must be considered that rental demand for this type of product may be much lower than for movies.

The distributors argue that a rental right would likewise result in a lowering of the sale price on these titles for the same reasons that sales prices would fall for sell-through product of a non-collectable nature, and encourage their production. These titles are much less expensive to produce than feature films, but still require a reasonably substantial market in order to "break even". At current high prices, this sales quantity arguably cannot be achieved.

It is also argued that a rental right would encourage production of more "artistic", "narrow-cast" or "classical" titles which could never achieve commercial success by normal channels, but would be "collectable" enough to a sufficient market on a sales basis to justify their production. Again, distributors argue that this cannot happen until sales prices fall, and sales prices cannot fall without a rental right.

Parallel Practice with U.S.A.

According to industry spokesmen, there could be a serious disruption to the North-American market for PRCs if a rental right is established in the U.S.A., but not in Canada. Canadian dealers would buy their product in the U.S.A. at retail prices considerably below Canadian whole-sale prices, and the Canadian distribution system would be seriously threatened.

Import restrictions, even as proposed in the White Paper on Copyright Revision,³¹ are considered by industry sources likely to be ineffective in stopping what is foreseen as inevitable "arbitrage" in the PRC market in this event.

Thus, if a rental right is established in the U.S.A., there will be considerable economic pressure to establish one in Canada, if only to maintain the existing distribution apparatus.

³¹ From Gutenberg to Telidon, A White Paper on Copyright, Consumer and Corporate Affairs Canada and Department of Communications, Ottawa, 1984, page 23.

ARGUMENTS AGAINST A RENTAL RIGHT FOR VIDEO RECORDINGS
Drastic Change in Legal Tradition

Opponents of a rental right for video recordings hold that such a right would represent a drastic departure from the theory and practice of personal property law in general and copyright law in particular.³² It is argued that no other form of property can be subject to enforceable restriction on rental under Anglo-American law once a "first sale" has occurred. Rental of personal property is extremely common with such items as cars, tools, bicycles, office equipment, machinery, VCRs themselves, and other categories where:

- a) the consumer has no permanent or ongoing need for the product; or
- b) the price of purchase does not justify the limited utility needed by the consumer.

Virtually all of these types of products may embody underlying patents or trademarks, and are nonetheless freely rented and sold as demand warrants.³³

Finally, it is argued that such a drastic change in legal policy and precedent is completely unnecessary to redress the distortion claimed by the movie industry. For example, it is suggested that the following alternative merchandising schemes used by other industries should be employed, i.e.:

³² See Testimony of Nina Cornell and Jack Wayman re H.R. 1029, October 28, 1983.

³³ See Testimony of Jack Wayman, ibid., page 4.

- 1) rebate to consumers (not retailers) for purchased PRCs
- 2) dealer incentives for sales
- 3) direct sale (i.e. by mail) to consumers so that sale profits go to the movie companies
- 4) direct rental to consumers so that rental profits go to the movie companies
- 5) establishment of rental/sale outlets by the movie companies
- 6) continued price experimentation by the movie companies³⁴

Possible Economic Harm to Consumers

Opponents of the rental right in the U.S.A. argue that several adverse results will befall consumers if the First Sale Doctrine is repealed. Some of these points will be discussed below as aspects of the competition/anti-trust issue.

However, the immediate concern of some of the critics is that rental prices will rise substantially, whether a royalty/licensing scheme is used or simply a surcharge. One critic estimates that the surcharge method for "rental only" cassettes could, based upon examples, result in a tripling of the dealer cost on these PRCs which would almost certainly result in higher prices to the consumer for rentals of anywhere between \$2.32 to \$3.63 per transaction, or approximately a 46% to 72% increase, assuming a retail price of \$5.00 per transaction prior to the enactment of a rental right.³⁵

³⁴ See Testimony of Jack Wayman, op. cit., page 11 ff.

³⁵ See Nina Cornell, Testimony, op.cit., pages 16-17.

Outflow of Royalties

While precise figures cannot be generated, it is virtually certain that well over 80% of increased revenues earned by copyright owners and distributors as the result of a rental right would ultimately accrue to the benefit of foreign companies which control almost all of the product now in rental demand in Canada. For example, in 1981, 80% of theatrical distribution revenues in Canada went to foreign owned distributors, mainly in Hollywood, and less than 1% of these revenues derived from distribution of Canadian films. See Department of Communications National Film of Video Policy, May 1984, page 37.

Based upon current estimates of a retail rental market in Canada worth \$150,000,000 for 1984, and a purely hypothetical direct or indirect royalty of 25% of average retail costs, there could be an outflow of approximately \$30,000,000 per year to the U.S.A. (ie. 80% of an increase of \$37,500,000). This should be compared to the estimated outflow of only \$10-\$15 million (1984) (based on 2% to 3% of total cable revenues) which it is estimated would result from the imposition of a cable retransmission right. The possibility of such a retransmission right has generated great controversy for that reason alone.

Disruption of Retail Industry

Retailers of PRCs, whether primarily engaged in rental or sale, can generally be expected to oppose a rental right.³⁶

³⁶ However, one prominent American franchise chain, National Video, has gone on record as supporting it. See Testimony of Ron Berger re H.R. 1020, April 29, 1983.

Generally, it is argued that the retail rental market is extremely competitive, and that any decrease in rental transactions resulting from higher rental costs would force many retailers out of business.³⁷

Another study has concluded that a shift towards a sales oriented market would, over the next three years, result in a decrease of profits to retailers of 21% with increases of profits to wholesalers of 57%, to copyright owners of 23%, and to duplicators of 200%.³⁸

There are also other ways in which existing rental retailers could be prejudiced. For example, the imposition of substantial royalties could result in some of these costs being borne by retailers, who complain that their profit margin is now as low as possible.

Furthermore, and especially given that anti-trust and competition laws are generally seen to be weaker in Canada than in the U.S.A., there is some concern that copyright owners or distributors may attempt to vertically integrate into the retail rental business and unfairly compete against independent retailers who would be subject to the imposition of royalties or other conditions imposed by their suppliers who would also be their direct competitors.

Competition and Anti-Trust Issues

Some of the strongest criticism of the current U.S.A. proposals is focussed on anti-trust issues. It is beyond the scope of this paper to examine those issues in any detail. However, they will be mentioned very briefly.

³⁷ See Testimony of Nina Cornell, op. cit., page 32.

³⁸ See Fairfied Group study, as summarized in Appendix IV.

It has been suggested that the repeal of the first sale doctrine in the U.S.A. would potentially legitimize conduct which is now per se illegal, or at least subject to a case-by-case analysis, according to the "rule of reason".³⁹ Specifically, it is argued that although copyright protection has never availed as a defence to price-fixing, nonetheless a strong incentive to fix prices (which is a vertical restraint) would exist with a rental right. It is also argued that the movie industry would attempt to impose "blockbooking" conditions on retailers, which are a horizontal restraint and utilize the ultimate control of refusal to permit rentals to effect these ends.⁴⁰

Strong rebuttals have been filed by Robert Pitofsky and Owen M. Johnson to the effect that no sanction would be conferred by the proposed legislation to behaviour which is now illegal. It is also argued that the fundamental notion of the "first sale doctrine" in general has been significantly eroded by the U.S. Supreme Court decision in Continental T.V. Inc. v. GTE Sylvania Inc.⁴¹

Similar issues can be expected to be raised in Canada, notwithstanding that no facile comparison can be made between American and Canadian competition law.⁴²

³⁹ See Testimony of Professor Harry First re S. 32 and S. 33, April 29, 1983.

⁴⁰ See also Testimony of Robert McEwen re S. 32 and S. 33, April 29, 1983.

⁴¹ See 433 U.S. 36 (1977).

⁴² For a discussion of the Sylvania case in the context of Canadian competition law, see Roberts, Anticompetitive and Antitrust, Butterworths, 1982, page 266. (See also S.D. Khosla and R.D. Anderson, The Monsanto Case and the Evolution of PRM Policy in the U.S., Canadian Competition Policy Record, v. 5, no. 3, September 1984, p. 9 in which the Sylvania case is also discussed.

The "first sale doctrine" and its competition implications have been recently discussed at some length in a Supreme Court of Canada decision on "grey marketing" or parallel importation.⁴³ The Court showed a strong predilection towards a pro-competition interpretation of any statutory or common laws pertaining to intellectual property.⁴⁴

Natural Economic Forces Will Achieve Goals Sought by Legislation

Critics of a rental right in the U.S.A. point out that one of its apparent main justifications - the stimulation of sales through lower prices - not only can be but already has been achieved in the industry without legislative change. Certain companies such as Paramount and Warner have been leaders in price-cutting on titles such as "Raiders of the Lost Ark" at \$39.95 (U.S.) (SLP) and "Purple Rain" at \$29.95 (U.S.) (SLP) respectively. Sales of items such as this have been especially successful, and Paramount continues this type of practice, notwithstanding that the rental retailer also enjoys a "free ride" at the lower price.⁴⁵

⁴³ See Seiko Time Canada v. Consumers Distributors, 10 D.L.R. (4th) 161 (June 21, 1984) at p. 171, 174.

⁴⁴ For a commentary on the competition and intellectual property aspects of this case in the lower courts, see Howard Knopf, Competition laws in Limbo, Marketing Magazine, March 14, 1983.

⁴⁵ See Cornell, Testimony re H.R. 1029, op. cit., page 20 ff. In fact, certain non-public domain feature films began to be released at \$19.95 (U.S.) (SLP) in July of 1984. There are predictions that the SLP of some "mega-hits", classics, children's programming and "how-to" titles could drop to as low as \$14.95 (U.S.) by the end of 1985. See Bilboard, Jan. 12, 1985, p. 23.

Moreover, it can be argued that the general fall of prices predicted by the major film companies is largely irrelevant to consumers, since most titles are not "collectable" by their very nature at any reasonable price.

According to Cornell, the price experimentation strategy has now been adopted by other major studios such as Disney. She states:

"It is possible that the change in copyright law might cause movie companies to lower sales prices somewhat more, or to lower prices on more titles. It is doubtful, however, that much stimulation of sales can be credited to the account of this amendment and offset against the small sales effect must be the adverse effect it will have on consumers who rent. The most dramatic changes in the sales market are occurring now, without any change in the copyright law."⁴⁶

Constitutional Issues

The power of the Federal government to legislate in respect of copyright derives from S. 91(23) of the British North American Act of 1867, now the Constitution Act of 1982. To the extent that copyright is or resembles personal property,⁴⁷ it is arguable that substantive restrictions on its alienation may be outside of federal jurisdiction since

⁴⁶ Cornell, op. cit., page 22.

⁴⁷ This is the general consensus. See Halsbury's Laws of England, 4th Ed., Vol. 35, paragraph 1104, Crosley Vanes on Personal Property, 5th Ed., p. 12, and Compo v. Bluecrest (1979) 105 DLR, 3rd Ed., 249 (S.C.C.).

"property and civil rights", including contract law, are provincial matters. The present Copyright Act deals with contractual matters only in an incidental way relating to formalities, registration, etc.

However, the control of "vending" by third parties is not foreign to patent law which is also a head of federal power. A patentee has been held to have the right to control alienation by third parties, provided they are on notice of the restriction sought to be imposed. This is a right which does not exist in the case of ordinary chattels.⁴⁸ In fact, the phrase "vending to others to be used" is included in S. 46 of the Patent Act and has not been challenged from a constitutional standpoint.⁴⁹

Moreover, it can be argued that although a "rental right" was not envisaged at the time copyright was made a head of federal power when the B.N.A. Act was passed in 1867, it is properly part of a general regulatory scheme with respect to the exercise of the copyright power. The courts have evolved the "living tree" doctrine which permits

⁴⁸ See National Phonograph Co. of Australia v. Menck (1911), 28 R.P.C. 229 at 245. See also Fox, Canadian Patent Law, 1969, pages 288, 289, 298-302.

⁴⁹ Although the Patent Act confers the right of "making, constructing, and vending", there is a widespread view that any substantial exercise of the right to vend in order to control alienation by third parties might run afoul of S. 29 of the Combines Investigation Act which is aimed at patents and trademarks. See D.W. Henry, Patents in Relation to the Combines Investigation Act, Bulletin at the Patent and Trade Mark Institute of Canada, Series No. 7, V. 17, July 1966, 1 at page 9.

an interpretation of Canada's laws to keep abreast of changing conditions.⁵⁰

The limitations of this paper preclude a detailed discussion of these points. However, while a reasonable basis for the constitutionality of a rental right as part of copyright law appears to exist, the issue may well be raised in any court proceedings to enforce the proposed right.

⁵⁰ See Re Section 24 of the B.N.A. Act [1930] 1 D.L.R. 98, at page 106, and Reference Re Validity of Section 1981 of the Railway Act, R.S.C. 1954, C. 234, (1956) 2 D.L.R., 2nd 93 at page 108.

HOME VIDEO IN THE OVERALL FILM INDUSTRY

The market for PRCs is beginning to emerge as one of the major revenue sources for film producer/distributors. In fact, it now appears that PRC sales and rentals account for approximately an equal share of revenues to producers and distributors as does Pay TV in the U.S.A., namely, approximately 10%-14% each.⁵¹ In fact, PRCs may shortly surpass Pay TV as a studio revenue source.

Industry sources in Pay TV, cable television, and home video all agree that PRCs have, at the very least, curtailed the growth of Pay TV, and many sources claim that they are now a threat to its viable existence.

It is also possible that PRCs may be potentially far more lucrative to studios than Pay TV. Under the current market structure for Pay TV in the U.S.A., studios receive approximately 20¢-50¢ per subscriber for the licensing of a film.⁵² In Canada, this figure would not be atypical, but the extreme ranges of it may be wider.

On the other hand, a PRC can generate much more revenue to a studio if revenue per viewer is analyzed. At the present time, a title destined for rental will bear a "surcharge" to the dealer of at least \$50.00 in most cases, over and above the price at which the distributor could sell it realizing a profit based upon a lower "sell-through" price. If the dealer rents this particular cassette 100 times at \$3.00 per transaction, the dealer will have made a

⁵¹ See Table V.

⁵² See Andrew Pollock, Hollywood Thriving in Video-Cassette Boom, New York Times, May 7, 1984, page 1.

gross profit of approximately \$200.00 (assuming a purchase price of \$100.00) before allowing for overhead and not providing for the residual value of the tape for future rentals or sale as a used item. The distributor will have realized at least 50¢ per rental transaction in this case. In most cases, the amount will be more because the number of rentals will be less.

Thus, it is possible the PRC market already is showing a greater profit per view to studios than the Pay TV market can.

Many industry sources believe that "Pay-per-view" service will make Pay TV more competitive with PRCs, in allowing earlier showings of major films and, in effect, giving the subscriber more choice in how his subscription money is spent.

However, the main reasons for present and predicted success of the PRC market are:

- 1) Convenience - The user can see any available title whenever he wishes as many times as he wishes.
- 2) Selection - There are at least 6,000 titles currently available for rental.
- 3) Earlier Window - Normally, rental titles are available 4-6 months after theatrical release. Pay TV is normally several months later. This is unlikely to change in the foreseeable future, since earlier release on Pay TV would result in significant home taping and impair both the theatrical and rental market.

Given the above state of the market, it is not surprising that studio/distributors seek greater control and participation in a market that promises great growth and which may assume economic significance second only to that of first run theatrical release in the next few years.

THE SOUND RECORDING RENTAL ISSUE

Sound recordings in North America are not rented by consumers for the same reasons that videocassettes are rented. Most records cost less than \$10.00 retail and are bought as "collectable" items, i.e. to be used repeatedly by the consumer. Moreover, many consumers are already familiar with the recording or the music in it or both before it is purchased; otherwise, it would not have been purchased.

The main reason that sound recordings are rented is that, under certain market conditions, consumers will make copies of them at a substantial cost saving compared to a purchase. A blank tape of reasonable quality costing \$3.00 or \$4.00 can hold two long playing records rented for, perhaps, a total of \$1.00 to \$4.00. Thus, for a total expenditure of \$4.00 to \$8.00, the consumer has acquired two sound recordings which might have otherwise cost \$20.00. If the tape is reused for other recordings, the cost to the consumer is even less. Arguably, the copyright owners in the sound recording as well as the music are deprived of royalties from sales that would, in many instances, have otherwise taken place.

The record industry would not, in any likelihood, ever seek to collect royalties on record rentals but would probably use the right to prohibit such rentals. Since the record rental industry is not very widespread or well-developed in North America, this should not cause great disruption of the retail sector.⁵³

⁵³ See Pollock, op. cit., page 1.

The record industry is also concerned that the new compact discs (which are currently at least 50% to 100% more expensive than normal recordings and which theoretically never wear out) lend themselves ideally to rental operations.

The music publishing industry may also be interested in securing a rental right in the music as embodied in sound recordings. Unlike films, sound recordings normally involve several distinct copyrights which remain owned by different entities. The copyright in the sound recording is normally owned by the record company or producer, while the copyright in the music itself is owned by a music publisher or composer. Normally, royalties to music publishers are paid according to sales, and rentals arguably diminish sales. Accordingly, the American legislation which establishes a record rental right provides that the copyright owner of the music embodied in a sound recording has the exclusive right to authorize rental but is deemed to have given a compulsory license to the copyright owner of the sound recording for rental purposes, according to a pro-rata scheme based upon the proportion of the music contained in the entire recording and the music owned by the particular publisher. Precise quantities of royalties have not as yet been determined, nor has the split between record companies and music publishers.⁵⁴

A bill creating a rental right for sound recordings has now become law in the U.S.A.⁵⁵

⁵⁴ See Testimony of Stanley Gortikov, Pres. RIAA, re H.R. 1027, October 6, 1983.

⁵⁵ H.R. 5938 and S. 32, P.L. 98-450.

RENTAL RIGHT FOR OTHER SECTORS

The White Paper on copyright revision proposes that a rental right can be provided for other sectors by order of the Governor in Council.

The computer software sector in Canada is currently subject to a phenomenon closely akin to rental, whereby certain enterprises are making software available for "evaluation" purposes for a typical charge of \$10.00, while the actual retail cost of the software may be several hundred dollars.

Any person competent in the basic use of computers with access to a machine with two disk drives (or in some cases only one) can usually copy this software in seconds for the cost of a blank disk (i.e. \$2.00-\$4.00). Program locks are a small deterrent but not particularly effective. The computer software industry may have a very strong case for a rental right for computer programs stored in a form readily capable of being "loaded" into a computer such as in disc, cartridge, or tape formats.

In order not to achieve unintended results, such a right would necessarily have to be drafted in such a way that it did not include programs not readily capable of being "loaded" into a computer. For example, many consumer and industrial items ranging from appliances to automobiles and computers themselves contain such programs in "read only memory" and should not be caught by such a right. It may suffice to limit the right to programs which exist in any commercially available form apart from the device which they have been devised to operate.

A bill to prohibit the rental of computer programs has been recently introduced in the U.S. Senate by Senator Matthias (S. 3074).

Other sectors which suffer manifest economic harm from the rental of copyright material could also seek to be protected by order of the Governor in Council.

THE LIBRARY EXEMPTION

If a rental right is ever enacted in any way for any type of work, there are strong policy reasons why it should not affect the activities of legitimate public, institutional and other non-profit libraries. Such organizations now lend video-cassettes, records, tapes and even computer programs to the public and do not achieve commercial gain in the process. Such activity is arguably highly necessary for libraries to fulfill their time-honoured educational and research-facilitating role. An appropriate explicit exemption would be necessary. Of course, such an exemption should not permit the existence of "clubs" whose major "raison d'être" is the exchange or rental of these types of material.

The possible imposition of some type of public "lending" right (as opposed to "rental" right) is another matter completely and has been discussed in the White Paper at page 21.

CONCLUSION

This analysis of the rental right for films and sound recordings attempts to outline, at a basic level, the arguments in favour and against such a right in Canada. It is not intended to be absolutely comprehensive in terms of breadth or depth of analysis of the legal and economic issues involved, but will hopefully assist in subsequent policy, legal, and economic discussions.

If further public discussion warrants, the Department may undertake first hand economic data acquisition in the Canadian context and a more detailed study.

VCRs in Canada (cumulative)

<u>Year</u>	<u>Number of VCRs</u>	<u>% of total households who own VCR</u>	<u>Source</u>
End of 1984	1,800,000		CBC's report
End of 1983	900,000		CBC's report
End of 1983	800,000	12% ¹	Eberstadt
May 1983	552,000	6.4%	Stat-Can 64-202, May 83
Sept. 1983	676,800	8.0%	CROP Bulletin 83-5-22
Nov. 1982	495,240	6.0%	CROP report
Nov. 1980	78,070	1.0%	CROP report

¹ Eberstadt has written that 800,000 VCRs correspond to a rate of penetration of 12%. Given the number of households in Canada by 1983, the penetration should be about 9%.

Cumulative U.S. VCRs sales (000,000 units)

<u>Year</u>	<u>M.P.A.A.</u>	<u>Eberstadt</u>	<u>Fairfield</u> ³
1976	.03		
77	.19		
78	.59		
79	1.07	1.0	
80	1.88		
81	3.24		
82	5.28	5.2	
83	8.19 (E) ¹	8.0 (E) ¹	
84	11.60 (E)	14.0 (E)	11.4 (A) ²
85	15.65 (E)	20.0 (E)	
86	20.41 (E)	25.0 (E)	
87	26.05 (E)	30.0 (E)	33.6 (A)
88	32.67 (E)	35.0 (E)	
89	40.52 (E)		
90	49.78 (E)		

- Sources: - Motion Picture Association of America (M.P.A.A.),
Videocassette recorders and the law of copyright,
1983.
- Eberstadt and Co. Inc., The prerecorded home
entertainment industry, December 14, 1983 p. 26-27
- The Fairfield Group, Inc., Who in the distribution
system benefits from the trend toward low-priced
sales of prerecorded video?, March 20, 1984

Note: 1: E: estimated
2: A. assumption
3: This study does not provide this figure explicitly
but it is an implicit assumption

Worldwide¹ VCRs in 1984

Canada	1,500,000	North America
U.S.A.	13,200,000	
Mexico	400,000	
Argentina	600,000	South America and Central America
Brazil	380,000	
Colombia	400,000	
Panama	50,000	
Venezuela	500,000	
Denmark	320,000	Europe
England	6,400,000	
Finland	215,000	
France	2,100,000	
Iceland	27,000	
Netherlands	950,000	
Norway	230,000	
Spain	1,000,000	
Sweden	650,000	
West Germany	4,400,000	
India	610,000	Asia
Indonesia	600,000	
Israel	350,000	
Japan	11,500,000	
Kuwait	366,000	
Lebanon	300,000	
Philippines	500,000	
Saudi Arabia	800,000	
Thailand	850,000	
Turkey	750,000	
Egypt	170,000	Africa
Ivory Coast	130,000	
South Africa	425,000	
Australia	1,600,000	Oceania
Fiji	14,000	
New Zealand	130,000	

All the numbers are MPAA estimates as reported in Variety 84/10/10 p. 50 except for those of Sweden, Denmark, Norway, Finland and Iceland for which data comes from official statistics of these countries, industry sources and Variety research as reported in Variety 84/10/10 p. 89.

¹ According to MPAA estimates, worldwide population of VCRs will exceed 56,000,000 in 1984.

Who in a distribution system benefits from the trend toward low-priced sales of PRCs?

Below are listed the assumptions on which this study has been constructed and presented the essential results.

1. Assumptions

- a) Constants (common to all scenarios)
 - 70% of VCR owners spend money on PRCs
 - these consumers (70%) spend an average of \$225/year
 - rental price is about \$5
- b) Assumptions for the 1984's scenario
 - there are 8M VCR owners who buy or rent PRC ---
11,4 M of VCR owners
 - 71% of the retailer's revenue comes from rentals
- c) Assumptions for "1987 rental-oriented" scenario
 - same assumptions than the previous scenario except:
 - there are 23,5 M VCR owners who spend on PRC ---
33,6 M VCR owners
 - each PRC consumer buys 2.5 PRCs per year
- d) Assumptions for "1987 sale-oriented" scenario
 - retail sales prices drop dramatically to \$19.95 by 1987
 - at this price, sales constitute 60% of store's revenue
 - each PRCs consumer buys 7 PRCs per year

2. Results

		<u>1984 Rental</u>	<u>1987 Rental</u>	<u>1987 Sales</u>	Profits 1987 Sales vs Rentals
Retailer	Revenues	1,800,000,000	5,300,000,000	5,300,000,000	-21%
	Profits	1,200,000,000	3,300,000,000	2,600,000,000	
	Gross	66%	62%	49%	
	Margin				
Whole saler	Revenues	540,000,000	1,400,000,000	2,200,000,000	+57%
	Profits	65,000,000	165,000,000	260,000,000	
	Gross	12%	12%	12%	
	Margin				
Program Owner	Revenues	475,000,000	1,200,000,000	1,900,000,000	+23%
	Profits	330,000,000	980,000,000	1,200,000,000	
	Gross	70%	81%	62%	
	Margin				
Dupli- cator	Revenues	145,000,000	227,000,000	720,000,000	+200%
	Profits	23,000,000	40,000,000	120,000,000	
	Gross	17%	17%	17%	
	Margin				

Source: Fairfield Group's study, March 20, 1984

Breakdown of the sources of revenues for studios

	(W) 1977	(G) 1978	(G) 1980	(W) 1982	(G) 1983(E)	(G) 1988(E)
Theatrical U.S. Rentals	51.6	49.3	46.7	41.8	37.8	55
Theatrical Foreign Rentals	30.0	30.8	28.7	17.0	23.4	
Pay T-V	1.4	2.0	5.4	17.4	10.0	16
Tape U.S.	-	-	.7	8.0	8.4	16
Tape Foreign	-	-			5.6	
Network License	13.1	10.3	18.8	8.7	6.7	4
Syndication - Fees	3.7	3.7	3.6	6.9	2.4	
Foreign TV	?	2.9	3.2	?	2.8	
Disc	-	-	-	included with tape	2.2	
Other	.2	1.0	.9	.2	.7	
Total	100	100	100	100	100	100

9

G: Goldman and Sachs study, March 1, 1984

W: Wertheim and Co. in Business Week, February 21, 1983

Number of Outlets

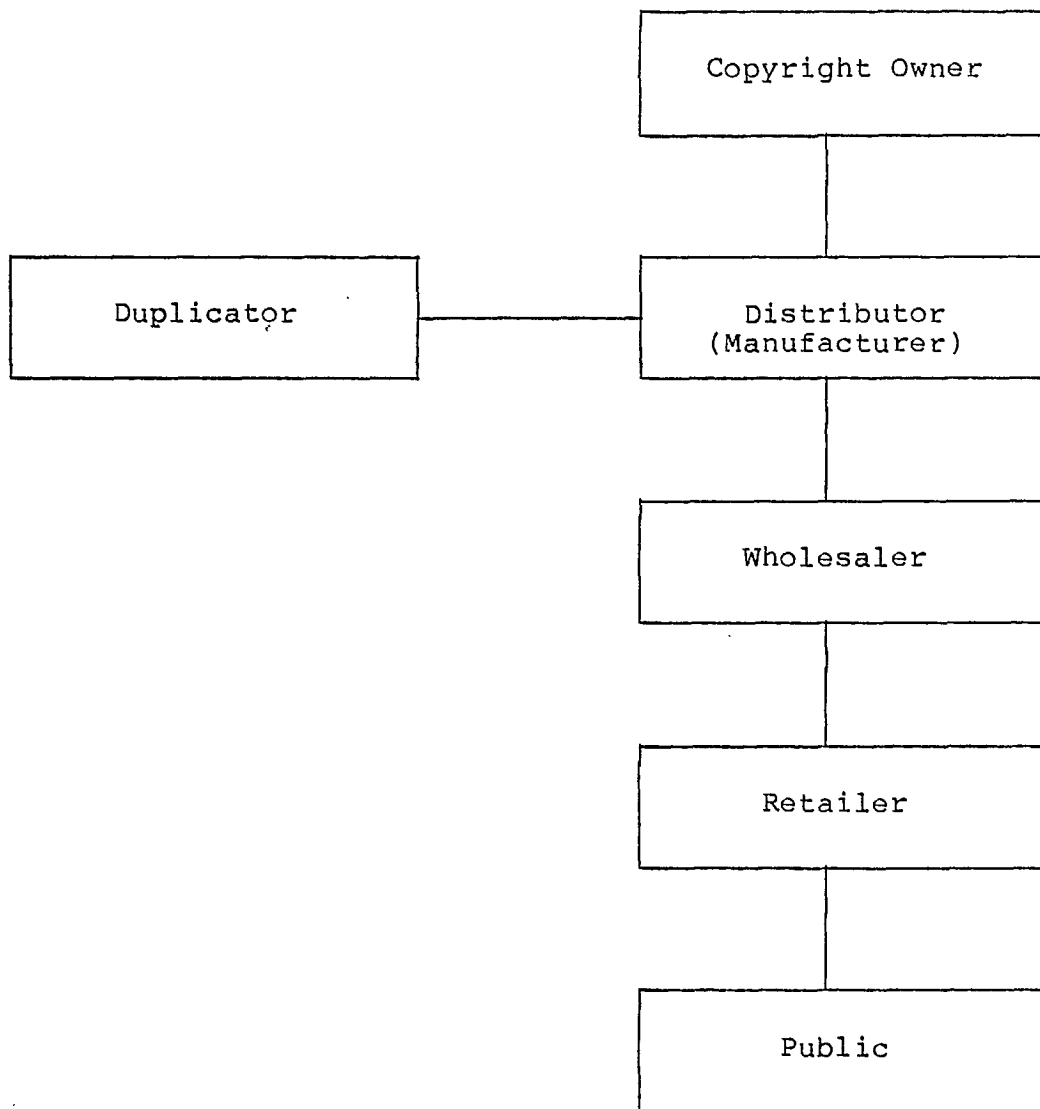
CANADA

<u>Year</u>	<u>Number</u>	<u>Source</u>
April 84	2,500	Industry sources
1983	1,500-2,000	Home Video Board of Canada in Variety 83/11/23, p. C32.

U.S.A.

<u>Year</u>	<u>Number</u>	<u>Source</u>
1983	14,000	V.S.D.A. in Variety 83/11/02, p. 38.
1983	10,000	Nielsen and Co. in Variety 83/09/07, p. 38.
1983	6,000-12,000	U.C.L.A. study
1983	10,000	Eberstadt Study
1983	8,000-10,000	Vestron in Variety 84/01/04, p. 57.
1982	7,000	Ron Berger, pres. of National Video
1982	5,000	Nielsen and Co. in Variety 83/07/20
1982	5,000	Washington Post 82/03/30, p. B16.

TYPICAL STRUCTURE OF
DISTRIBUTION CHAIN FOR PRCS



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Knopf, Howard P.
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