

**UNITED STATES – SECTION 110(5)  
OF THE US COPYRIGHT ACT**

**RECOURSE TO ARBITRATION  
UNDER ARTICLE 25 OF THE DSU**

**AWARD OF THE ARBITRATORS**

The award of the Arbitrators in *United States – Section 110(5) of the US Copyright Act – Recourse to Arbitration under Article 25 of the DSU* is being notified to the Dispute Settlement Body and the TRIPS Council where any Member may raise any point relating thereto, pursuant to Article 25.3 of the DSU. The award is being circulated as an unrestricted document from 9 November 2001 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1).

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## I. INTRODUCTION

### A. PROCEEDINGS

1.1 On 23 July 2001, the European Communities (EC)<sup>1</sup> and the United States (hereinafter also the "parties") notified to the Dispute Settlement Body (DSB) their mutual agreement to resort to arbitration pursuant to Article 25 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereafter the "DSU").<sup>2</sup> The stated object of the arbitration was to determine the level of nullification or impairment of benefits to the European Communities as a result of the operation of Section 110(5)(B) of the US Copyright Act.

1.2 The parties have resorted to this arbitration further to the adoption by the DSB of the report of the panel which, at the request of the European Communities, reviewed the compatibility of Section 110(5) of the US Copyright Act,<sup>3</sup> as amended by the Fairness in Music Licensing Act of 1998,<sup>4</sup> with the Agreement on Trade-Related Aspects of Intellectual Property Rights.<sup>5</sup> The conclusions and recommendations of the panel<sup>6</sup> read as follows:

"7.1 In the light of the findings in paragraphs 6.92-6.95, 6.133, 6.159, 6.211, 6.219, 6.266 and 6.272 above, the Panel concludes that:

- (a) Subparagraph (A) of Section 110(5) of the US Copyright Act meets the requirements of Article 13 of the TRIPS Agreement and is thus consistent with Articles 11*bis*(1)(iii) and 11(1)(ii) of the Berne Convention (1971) as incorporated into the TRIPS Agreement by Article 9.1 of that Agreement.
- (b) Subparagraph (B) of Section 110(5) of the US Copyright Act does not meet the requirements of Article 13 of the TRIPS Agreement and is thus

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<sup>1</sup> For the purpose of these proceedings, references to the "European Communities" shall be deemed, wherever applicable, to refer to the European Communities and their Member States.

<sup>2</sup> See WT/DS160/15. Article 25 of the DSU reads as follows:

"1. Expeditious arbitration within the WTO as an alternative means of dispute settlement can facilitate the solution of certain disputes that concern issues that are clearly defined by both parties.

2. Except as otherwise provided in this Understanding, resort to arbitration shall be subject to mutual agreement of the parties which shall agree on the procedures to be followed. Agreements to resort to arbitration shall be notified to all Members sufficiently in advance of the actual commencement of the arbitration process.

3. Other Members may become party to an arbitration proceeding only upon the agreement of the parties which have agreed to have recourse to arbitration. The parties to the proceeding shall agree to abide by the arbitration award. Arbitration awards shall be notified to the DSB and the Council or Committee of any relevant agreement where any Member may raise any point relating thereto.

4. Articles 21 and 22 of this Understanding shall apply *mutatis mutandis* to arbitration awards."

<sup>3</sup> United States Copyright Act of 1976, Act of 19 October 1976, Pub.L. 94-553, 90 Stat. 2541 (as amended).

<sup>4</sup> Fairness in Music Licensing Act of 27 October 1998, Pub.L. 105-298, 112 Stat. 2830, 105<sup>th</sup> Cong., 2<sup>nd</sup> Session (1998), hereinafter the "1998 Amendment".

<sup>5</sup> Hereafter the "TRIPS Agreement".

<sup>6</sup> See the Panel Report on *United States – Section 110(5) of the US Copyright Act* (hereafter "*US - Section 110(5) Copyright Act*"), WT/DS160/R, adopted 27 July 2000. The original panel will be hereafter referred to as the "Panel".

inconsistent with Articles 11*bis*(1)(iii) and 11(1)(ii) of the Berne Convention (1971) as incorporated into the TRIPS Agreement by Article 9.1 of that Agreement.

7.2 The Panel *recommends* that the Dispute Settlement Body request the United States to bring subparagraph (B) of Section 110(5) into conformity with its obligations under the TRIPS Agreement."<sup>7</sup>

1.3 The parties requested the Chairman of the DSB to contact the original panelists in the dispute, to determine their availability to serve as arbitrators.<sup>8</sup> The Chairperson of the original panel, Mrs. Carmen Luz Guarda and one Member, Mr. A. V. Ganesan, were no longer available. In accordance with the agreed procedures for the selection of the arbitrators contained in document WT/DS160/15, the Director-General appointed two arbitrators<sup>9</sup> to replace them.

1.4 On 13 August 2001, the Members were informed that the names of the Arbitrators were the following<sup>10</sup>:

Chairman: Mr. Ian F. Sheppard

Members: Mrs. Margaret Liang  
Mr. David Vivas-Eugui.

1.5 Following an organizational meeting with the parties on 13 August 2001, the Arbitrators developed their Working Procedures and timetable on the basis of the agreed procedures and timetable for Article 25 arbitration annexed to the parties' communication to the Chairman of the DSB on their recourse to Article 25 of the DSU.<sup>11</sup>

1.6 The jurisdiction of the Arbitrators is contained in document WT/DS160/15 which reads, in relevant parts, as follows:

"The United States and the European Communities (EC), having mutually agreed pursuant to Article 25.2 of the Understanding on Rules and Procedures for the Settlement of Disputes (DSU) to enter into arbitration to determine the level of nullification or impairment of benefits to the EC as a result of Section 110(5)(B) of the US Copyright Act, respectfully request that you contact the original panelists in the dispute "United States – Section 110(5) of the US Copyright Act" (WT/DS160), to determine their availability to serve as arbitrators in this proceeding. [...]

The parties agree that the award of the arbitrator shall be final, and they shall accept it as the level of nullification or impairment for purposes of any future proceedings under Article 22 of the DSU related to this dispute."

1.7 In accordance with the timetable, the European Communities submitted a methodology paper on 14 August 2001. Both parties made concurrent written submissions on 21 August 2001. They submitted concurrent written rebuttals on 28 August 2001. The Arbitrators met with the parties on

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<sup>7</sup> Panel Report on *US - Section 110(5) Copyright Act*, *supra*, paras. 7.1 and 7.2.

<sup>8</sup> See WT/DS160/15.

<sup>9</sup> The group of three arbitrators will be hereafter referred to as the "Arbitrators".

<sup>10</sup> See WT/DS160/16.

<sup>11</sup> See WT/DS160/15.

5 September 2001. Replies to questions of the Arbitrators were received on 11 September. Parties were allowed to comment on each other's replies by 14 September 2001.<sup>12</sup>

1.8 The Arbitrators issued their award to the parties on 12 October 2001. The award was notified to the DSB and the TRIPS Council in application of Article 25.3 of the DSU on 9 November 2001.

B. PROCEDURAL ISSUES WHICH AROSE IN THE COURSE OF THE PROCEEDINGS

**1. Treatment of replies to questions asked by the Arbitrators to some US collective management organizations**

1.9 On 5 September 2001, the **Arbitrators** decided to seek additional information from two of the US collective management organizations<sup>13</sup>: the American Society of Authors, Composers and Publishers (ASCAP) and Broadcast Music Inc. (BMI).<sup>14</sup> The Arbitrators consulted the parties on the questions asked to those CMOs. The parties did not object to the Arbitrators seeking such information.<sup>15</sup> The Arbitrators agreed that the parties might comment on any information submitted by the US CMOs. ASCAP and BMI were given until 14 September to reply. However, no reply was received on that date.

1.10 The Arbitrators were mindful of the particular circumstances which may have delayed any reply and considered that, should ASCAP and/or BMI provide at a later stage any information likely to influence significantly the calculations to be performed, the Arbitrators would seek comments from the parties on such information before finalizing their award. BMI submitted some information on 25 September 2001. However, BMI attached a number of conditions to the use of that information, in particular the obligation for the Arbitrators to submit "any proposed public document" to BMI's counsel in order for it to confirm that the confidentiality of the information submitted by BMI was effectively protected. The Arbitrators understood that the term "any proposed public document" could apply to their award. Having regard to their Working Procedures and to general practice under public international law, they considered that such a condition was incompatible with the confidentiality of their deliberations, which extends to the content of their report until it is made public. The Arbitrators also feared that such conditions, if they were accepted, could make access to evidence more difficult in future cases under the DSU. As a result, they decided not to use the information submitted by BMI on 25 September 2001.

1.11 ASCAP submitted its responses on 3 October 2001. On 4 October, the Arbitrators sought the views of the parties as to whether the information submitted should be taken into consideration. The **European Communities** considered that the information received from ASCAP did no more than repeat and confirm information already submitted by the parties to the Arbitrators and the Panel and did not justify delaying the issue of the award. The **United States** said that it would not object if the Arbitrators were to take into account the information from ASCAP but also stated that the new information merely confirmed the reasonableness of the US calculations.

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<sup>12</sup> The United States submitted comments on that date. The European Communities did not, but later contested the admissibility of certain pieces of evidence submitted by the United States. Regarding subsequent procedural issues, see Section I.B.1. below.

<sup>13</sup> Hereafter referred to as "CMOs".

<sup>14</sup> A third CMO is involved in this sector: the Society of European Stage Authors and Composers (SESAC). However, for reasons explained *infra*, the parties did not include SESAC's activities in their calculations. SESAC itself did not cooperate in the proceedings before the Panel. Having regard to the explanations given by the parties, the Arbitrators did not find it necessary to request information from SESAC.

<sup>15</sup> The request for information was conveyed in a letter addressed to the President and Chairman of the Board of ASCAP and to the President and Chief Executive Officer of BMI. For the text of the letter, see Annex I to this award.

1.12 BMI informed the Arbitrators on 10 October 2001 that it would submit additional information, without imposing the conditions which had lead the Arbitrators to disregard its previous submission of information.<sup>16</sup> The Arbitrators sought the views of the parties on the advisability of taking BMI new information into account. The **European Communities** stated that this information should not be taken into account if this further delayed the issue of the award. **The United States** considered that the Arbitrators possessed sufficient information to render a fair decision on the level of nullification or impairment of benefits caused by Section 110(5)(B). Nevertheless, if the Arbitrators preferred to await the information that BMI may submit, the United States had no objection. The United States nonetheless recalled that the "reasonable period of time" for implementation in this case expires on the earlier of the date on which the current session of the US Congress adjourns or 31 December 2001. In light of this time constraint and the parties' ongoing efforts to reach a consensual resolution of the dispute, the United States was interested in obtaining a fair decision expeditiously.

1.13 The **Arbitrators** recall that one of the main concerns expressed by the parties when this matter was referred to arbitration was that we proceed expeditiously. We note that, had we taken into account the information supplied by ASCAP and BMI, we would have had to delay considerably the date of the issue of our award. We emphasize in this regard that the European Communities has expressed the opinion that the information provided by ASCAP and BMI does not warrant any delay. We also note that the United States has not specifically requested us to consider ASCAP or BMI figures. We are, therefore, reluctant to postpone the issue of our award. We note in this respect that any delay in issuing our report shortens the time-period available to both parties to reach a mutually satisfactory solution before the end of the reasonable period of time agreed to by the DSB.

1.14 In the light of this procedural consideration, we conclude that we should not take account of the information made available by ASCAP and BMI.

## **2. Admissibility of some pieces of evidence submitted by the United States**

1.15 On 17 September 2001, the European Communities sent a letter to the Chairman of the Arbitrators objecting to the submission of certain pieces of evidence by the United States in its comments of 14 September 2001 on the replies of the parties to the questions of the Arbitrators. On 19 September, the Chairman of the Arbitrators sent a letter to the parties, the relevant parts of which read as follows:

"I refer to the letter of the European Communities (EC), dated 17 September 2001, addressed to me as Chairman of the Arbitrators in the above-mentioned case. In that letter, the EC refers to paragraph (f) of our Working Procedures of 16 August 2001 and claims that exhibits US ARB-25 and US ARB-26, attached by the United States to its comments of 14 September 2001, have been submitted belatedly and that "no showing of good cause" for granting an exception has been made. The European Communities concludes that the exhibits in question should be disregarded by the Arbitrators. In addition, the EC offers some comments on the substance of exhibit US ARB-26.

The Arbitrators recall that paragraph (f) provides as follows:

'(f) the parties shall submit all factual evidence to the Arbitrators no later than the first written submissions to the Arbitrators, except with respect to evidence necessary for purposes of rebuttal submissions. Exceptions to this procedure will be granted upon a

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<sup>16</sup> The information was received on 11 October 2001.

showing of good cause. In such cases, the other party shall be accorded a period of time for comments, as appropriate;'

The Arbitrators note that the United States has submitted new materials in the form of exhibits US ARB-25 and US ARB-26, as part of the comments which the parties were allowed to make on each other's replies to the questions of the Arbitrators. The Arbitrators also note that the EC has submitted comments both on the admissibility and on the substance of these exhibits. The Arbitrators conclude that, without prejudice to any ultimate decision they may take regarding the EC request, the EC has not been deprived of the possibility to comment under paragraph (f) of our Working Procedures.

Under those circumstances, the Arbitrators deem it appropriate to address the issues raised by the EC claims contained in the letter of 17 September 2001 in the arbitration award."

1.16 On 20 September 2001, the United States commented on the EC letter of 17 September, stating that it had good cause to submit the exhibits at issue, since they were intended to rebut statements made by the European Communities in its response to the written questions of the Arbitrators. In the opinion of the United States, these EC statements introduced new factual issues. The United States also contested the right of the European Communities to submit new arguments which did not respond to the rebuttals.

1.17 The Arbitrators note that the United States did not try to justify the submission of exhibits US ARB-25 and US ARB-26 in terms of paragraph (f) requirements when it submitted them. The United States claimed that it had good cause to submit those exhibits only in a subsequent letter of 20 September 2001. The Arbitrators are of the view that paragraph (f) should normally be interpreted to require the showing of good cause before or at the moment new evidence is presented, at the time or after the rebuttal submission. However, the circumstances of this case, the conditions under which the exhibits were submitted and the European Communities' reaction are special and justify that paragraph (f) be interpreted with some limited flexibility.

1.18 First, in a case where relevant information was scarce, and given the time-frame within which the Arbitrators were supposed to complete their work, any additional information was welcome at any time and *a priori* important in the light of the Arbitrators' duty to provide an objective assessment of the facts.

1.19 Second, the additional information was adduced by the United States as part of a rebuttal of EC arguments contained in its reply to questions of the Arbitrators, as agreed with the Arbitrators at the hearing. The Arbitrators note that the EC did not claim that the exhibits were not related to the rebuttal of EC arguments contained in its reply to questions from the Arbitrators.

1.20 Finally, whilst the US justification for its production of exhibits US ARB-25 and US ARB-26 was belated, in its response the European Communities did in fact deal with the substance of these exhibits. As the Chairman noted in his letter of 19 September 2001 to the parties, the EC has thus not been deprived of the opportunity to comment on the US exhibits.

1.21 Given these special circumstances, the Arbitrators hold that exhibits US ARB-25 and US ARB-26 are admitted in the procedure. As far as the substance of these pieces of evidence is concerned, the Arbitrators will revert to it as necessary in the course of this award.

### 3. Treatment of business confidential information submitted by the parties

1.22 Both parties have submitted some information on a confidential basis which they requested should not be communicated to private parties.<sup>17</sup>

1.23 The Arbitrators recall that the Panel agreed to treat some information from the European Communities and the United States as confidential, while also recalling that the designation of information as confidential did not assist the Panel in its responsibility to make findings that will best enable the DSB to perform its dispute settlement functions.<sup>18</sup>

1.24 In the absence of specific requests from the parties as to how confidentiality of business confidential information should be preserved, the Arbitrators will rely generally on the practice of the Appellate Body on this matter.<sup>19</sup> To the extent that confidential information may appear as such in the award in order to support the findings of the Arbitrators, the Arbitrators decided that two versions of the award would be prepared. One, for the parties, would contain all the information used in support of the determinations of the Arbitrators. The other, which would be circulated to all Members, would be edited so as not to include the information for which, after consultation with the parties, the Arbitrators would conclude that confidentiality for business reasons was sufficiently warranted. The information which the Arbitrators would consider to be business confidential would be replaced by "X".<sup>20</sup>

## II. SCOPE OF THE MANDATE OF THE ARBITRATORS

### A. JURISDICTION UNDER ARTICLE 25 OF THE DSU TO ADDRESS THE ISSUE REFERRED TO THE ARBITRATORS BY THE PARTIES

2.1 The Arbitrators note that this is the first time since the establishment of the WTO that Members have had recourse to arbitration pursuant to Article 25 of the DSU.<sup>21</sup> Whereas the DSB establishes panels or refers matters to other arbitration bodies, Article 25 provides for a different procedure. The parties to this dispute only had to *notify* the DSB of their recourse to arbitration. No decision is required from the DSB for a matter to be referred to arbitration under Article 25. In the absence of a multilateral control over recourse to that provision, it is incumbent on the Arbitrators themselves to ensure that it is applied in accordance with the rules and principles governing the WTO system.<sup>22</sup> As recalled by the Appellate Body in *United States – Anti-Dumping Act of 1916*<sup>23</sup>, it is a widely accepted rule that an international tribunal is entitled to consider the issue of its own jurisdiction on its own initiative. The Arbitrators believe that this principle applies also to arbitration

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<sup>17</sup> US first and second written submissions, exhibits US ARB-5, 7, 8, 9, 10, 12.

<sup>18</sup> See the Panel Report on *US - Section 110(5) Copyright Act, supra*, para. 6.208 and footnote 192, and para. 6.233 and footnote 209.

<sup>19</sup> See, in particular, the Appellate Body Report on *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, paras. 141-147.

<sup>20</sup> This approach was used in one Article 22.6 arbitration and does not seem to have met with objections in the DSB. See the Decision of the Arbitrators on *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* (hereafter "*Brazil – Aircraft (22.6)*"), WT/DS46/ARB, 28 August 2000, para. 2.14.

<sup>21</sup> The Arbitrators recall that arbitration was seldom used under GATT 1947.

<sup>22</sup> In particular, the Arbitrators believe that this arbitration should not be applied so as to circumvent the provisions of Article 22.6 of the DSU (See Article 23.2(c) of the DSU).

<sup>23</sup> See the Appellate Body Report on *United States - Anti-Dumping Act of 1916*, WT/DS136/AB/R and WT/DS162/AB/R, adopted 26 September 2000, para. 54, footnote 30.

bodies.<sup>24</sup> In case there be any question as to the jurisdiction of the Arbitrators to deal with this dispute, we provide brief reasons for our conclusion that we do have the necessary jurisdiction.

2.2 The Arbitrators recall that this arbitration has been called upon to address a particular issue resulting from the implementation of the DSB rulings and recommendations on the basis of the Panel Report on *US – Section 110(5) Copyright Act*. In that context, our mandate is to "determine the level of nullification or impairment of benefits to the European Communities as a result of Section 110(5)(B) of the US Copyright Act".<sup>25</sup>

2.3 The Arbitrators first note that, pursuant to the text of Article 25.1, arbitration under Article 25 is an "*alternative* means of dispute settlement".<sup>26</sup> The term "dispute settlement" is generally used in the WTO Agreement to refer to the complete process of dispute<sup>27</sup> resolution under the DSU, not to one aspect of it, such as the determination of the level of benefits nullified or impaired as a result of a violation. It may be argued that the procedure provided for in Article 25 is actually an alternative to a panel procedure. This would seem to be confirmed by the terms of Article 25.4, which provides that "Articles 21 and 22 of this Understanding shall apply *mutatis mutandis* to arbitration awards."<sup>28</sup> Article 22.2 itself, unlike Article 21.3(c), does not refer to arbitration as an alternative to the negotiation of mutually acceptable compensation. It could then be argued that arbitration under Article 25 is not intended for "determin[ing] the level of nullification or impairment of benefits to the European Communities as a result of Section 110(5)(B) of the US Copyright Act."

2.4 While being mindful of these elements of interpretation, the Arbitrators are of the view that they are outweighed by other elements, based on the fact that none of the provisions concerned expressly excludes recourse to arbitration under Article 25 in the particular context in which they apply. Article 25.2 itself provides that resort to arbitration shall be subject to mutual agreement of the parties which shall agree on the procedures to be followed "except as otherwise provided in this Understanding". Article 25 itself does not specify that recourse to Article 25 arbitration should be excluded when determining the level of nullification or impairment suffered by a Member. On the contrary, the terms of Article 25.1 referring to "the solution of certain disputes that concern issues that are clearly defined by the parties" may support the view that Article 25 should be understood as an arbitration mechanism to which Members may have recourse whenever necessary within the WTO framework. We also note that Article 22.2 refers to "negotiations [...] with a view to developing mutually acceptable compensation." There is no language in that provision which would make it impossible to consider arbitration as a means of reaching a mutually acceptable compensation.

2.5 Moreover, recourse to Article 25 arbitration in the present situation is fully consistent with the object and purpose of the DSU. Arbitration is likely to contribute to the prompt settlement of a

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<sup>24</sup> This is evidenced by Article 21 of the Optional Rules of the Permanent Court of Arbitration for arbitrations involving international organizations and States. See, Permanent Court of Arbitration: Optional Rules for Arbitration involving International Organizations and States, effective 1 July 1996, International Bureau of the Permanent Court of Arbitration, The Hague, The Netherlands.

<sup>25</sup> WT/DS160/15.

<sup>26</sup> Emphasis added.

<sup>27</sup> In a note by the GATT Secretariat on Concept, Forms and Effects of Arbitration (MTN.GNG/NG13/W/20, 22 February 1988), the term "dispute" is defined as a specific disagreement concerning a matter of fact, law or policy in which a claim or assertion by one party is met with refusal, counter-claim or denial by another.

<sup>28</sup> The text of Article 25 of the DSU is essentially identical to that of paragraphs 1, 2 and 3 of Section E of the 1989 Decision on improvements to the GATT dispute settlement procedures (BISD 36S/63). It is worth noting that, in that Decision, Section E follows other sections on means of resolution of disputes, such as consultations (Section C) and good offices, conciliation and mediation (Section D). Moreover, GATT 1947 did not provide for the sophisticated means of enforcement found in the DSU. The note MTN.GNG/NG13/W/20 of 22 February 1988, referred to above, also presents arbitration "as an alternative to the normal dispute settlement process" (para. 12) or "as an alternative to panel proceedings" (para. 17).

dispute between Members, as commanded by Article 3.3 of the DSU. Indeed, it may facilitate the resolution of a divergence in the context of a negotiation of compensations, thus paving the way to implementation without suspension of concessions or other obligations.

2.6 In general, recourse to arbitration under Article 25 strengthens the dispute resolution system by complementing negotiation under Article 22.2. The possibility for the parties to a dispute to seek arbitration in relation to the negotiation of compensation operates to increase the effectiveness of that option under Article 22.2. Incidentally, the Arbitrators note that compensation, in their opinion, is always to be preferred to countermeasures of any sort, since it enhances trade instead of restricting or diverting it. Finally, such an application of Article 25 does not, at least in the case at hand, affect the rights of other Members under the DSU.<sup>29</sup>

2.7 Having regard to the object of the arbitration requested by the parties and the fact that the rights of other Members under the DSU are not affected by the decision of the European Communities and the United States to seek arbitration under Article 25, the Arbitrators are of the view that, pending further interpretation by the Members, they should declare that they have jurisdiction under Article 25 to determine the level of EC benefits which are being nullified or impaired in this case.<sup>30</sup>

### III. CONCEPTUAL ISSUES

3.1 Since the present arbitration proceedings are the first ones in which a WTO adjudicating body is entrusted with the task of determining the level of benefits nullified or impaired as a consequence of an infringement of obligations under the TRIPS Agreement, it is necessary to address at some length two conceptual issues before undertaking any actual calculations of the level of nullification or impairment suffered by the European Communities in this case.

#### A. NATURE AND LEVEL OF BENEFITS NULLIFIED OR IMPAIRED

3.2 The first issue which the Arbitrators turn to examine concerns the nature and level of the benefits which are being nullified or impaired in the present case.

3.3 The **European Communities** submits that this case is special in that it involves the denial by the United States of exclusive rights which the United States is required under the TRIPS Agreement to grant to nationals of other WTO Members. The European Communities notes that, in contrast, in none of the past arbitration proceedings under Article 22.6 of the DSU did any of the entities affected by the relevant WTO-inconsistent measures enjoy any exclusive rights. Instead, they only enjoyed expectations as to the legal framework and factual conditions in which they could pursue their economic activities. The European Communities considers that, because the TRIPS Agreement guarantees specific exclusive rights rather than merely expectations, the proper way of measuring nullification or impairment of benefits in this case is by assessing the economic value of the denied exclusive rights.

3.4 With reference to the present dispute, the European Communities argues that a correct assessment of the value of the exclusive copyrights which are being denied to EC right holders as a consequence of Section 110(5)(B) cannot be made, unless it is assumed that all those establishments which use copyright works of EC right holders are licensed. The European Communities notes that, otherwise, those establishments would engage in acts of piracy. The European Communities therefore

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<sup>29</sup> As a matter of fact, it may affect them positively, given the *erga omnes* character of compensation.

<sup>30</sup> The Arbitrators' recognition of their jurisdiction in this case is not a unilateral extension of WTO jurisdiction, since it is dependent on the agreement of the parties to a dispute to have recourse to Article 25 of the DSU. This decision is without prejudice to the DSU compatibility of the decision of the parties to accept this award as the level of nullification or impairment for the purpose of any further proceedings under Article 22 of the DSU in relation to this case. It is also without prejudice to any interpretation of the provisions of Articles 22 and 25 of the DSU by the Ministerial Conference or the General Council.

is of the view that the economic value of the copyrights at issue in the present dispute corresponds to the licensing revenue *potentially* foregone by EC right holders as a result of Section 110(5)(B).

3.5 The **United States** considers that the level of nullification or impairment of benefits caused to the European Communities is equal to the annual benefits lost by EC right holders as a result of Section 110(5)(B). Like the European Communities, the United States believes that the level of nullification or impairment should be measured by reference to the licensing royalties lost by EC right holders. However, the United States disagrees with the European Communities' contention that it has lost benefits equal to the total licensing royalties that hypothetically could be collected. In the view of the United States, the most accurate and factually grounded way to quantify the lost benefits is to determine the benefits that EC right holders were receiving prior to the enactment of Section 110(5)(B).

3.6 According to the United States, the European Communities' proposed methodology should be rejected because it calculates foregone licensing royalties as though copyright holders would receive royalties from *every* user of radio or television music that is affected by Section 110(5)(B). The United States maintains that prior to the enactment of Section 110(5)(B) many bars, restaurants and retail establishments in the United States that could have played radio or television music were not licensed to do so. The United States submits that this absence of 100% licensing is to be expected, as the US CMOs which administer the rights of the copyright holders face substantial costs in licensing bars, restaurants and retail establishments. The United States argues that, given the geographically dispersed user base in the United States, it is not economically rational for US CMOs to locate and attempt to obtain and administer licenses for every establishment that plays radio or television music. The United States is therefore of the view that, because it disregards the cost of collecting and distributing royalties, the European Communities' proposed methodology produces a windfall for itself, which would be contrary to WTO rules and would unfairly penalize the United States.

3.7 The **European Communities** rejects the United States' argument that it would be "too costly" to license certain categories of businesses or businesses in certain areas of the United States. The European Communities submits that this is tantamount to suggesting that a WTO Member in which piracy rates are very high or where the enforcement of intellectual property is particularly difficult or costly is, for all practical purposes, released from its substantive obligations under the TRIPS Agreement.

3.8 The **Arbitrators** note that they are called on, in this case, to determine the level of nullification or impairment of benefits accruing to the European Communities as a result of the continued application of Section 110(5)(B). In respect of Section 110(5)(B), the Panel reached the conclusion that it was "[...] inconsistent with Articles 11*bis*(1)(iii) and 11(1)(ii) of the Berne Convention (1971) as incorporated into the TRIPS Agreement by Article 9.1 of that Agreement."<sup>31</sup> Neither party to this dispute contests that Section 110(5)(B), as currently in force, continues to be inconsistent with the provisions of the aforementioned articles.

3.9 It is clear, therefore, that the benefits which Section 110(5)(B) is impairing or nullifying are those which should accrue to the European Communities and other Members under the provisions of Articles 11*bis*(1)(iii) and 11(1)(ii) of the Berne Convention (1971)<sup>32</sup> as incorporated into the TRIPS Agreement by Article 9.1 of that Agreement.

3.10 It is apparent from the submissions of the parties that they do not so much differ regarding the *nature* of the benefits which should accrue to the European Communities under the provisions of Articles 11*bis*(1)(iii) and 11(1)(ii), but rather regarding the *level* of benefits which the

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<sup>31</sup> Panel Report on *US - Section 110(5) Copyright Act*, *supra*, para. 7.1(b).

<sup>32</sup> Articles 11*bis*(1)(iii) and 11(1)(ii) of the Berne Convention (1971) will hereafter be referred to as "Articles 11*bis*(1)(iii) and 11(1)(ii)".

European Communities could expect to accrue to it under those provisions. The Arbitrators will address these issues in turn.<sup>33</sup>

3.11 As concerns, first, the *nature* of the benefits which would accrue to the European Communities if Section 110(5)(B) were brought into conformity with Articles 11*bis*(1)(iii) and 11(1)(ii), it is well to recall at the outset what those Articles actually provide.

3.12 Article 11*bis*(1)(iii) reads:

Authors of literary and artistic works shall enjoy the exclusive right of authorizing:

[...]

(iii) the public communication by loudspeaker or any other analogous instrument transmitting, by signs, sounds or images, the broadcast of the work.

3.13 Article 11(1)(ii) states:

Authors of dramatic, dramatico-musical and musical works shall enjoy the exclusive right of authorizing:

[...]

(ii) any communication to the public of the performance of their works.

3.14 By virtue of Article 9.1 of the TRIPS Agreement<sup>34</sup>, the provisions of Articles 11*bis*(1)(iii) and 11(1)(ii) "[...] have become part of the TRIPS Agreement and as provisions of that Agreement have to be read as applying to WTO Members."<sup>35</sup>

3.15 For purposes of the present dispute, this means that the United States is under an obligation to make available to EC right holders the exclusive rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii).<sup>36</sup> It is important to bear in mind, however, that, while it is for the *United States* to *provide* EC right holders with the exclusive rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii), it is for *EC right holders* to determine whether and how to *exercise* or *exploit* those rights.

3.16 Although there may be a variety of ways in which EC right holders could exercise or exploit the exclusive rights which the United States must make available to them, the parties are in agreement

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<sup>33</sup> The Arbitrators note that, in those cases where users of copyright works are covered by Section 110(5)(B), the European Communities does not currently derive *any* benefits from the provisions of Articles 11*bis*(1)(iii) and 11(1)(ii). It is, therefore, of no account whether the question before the Arbitrators is framed as "What is the level of EC benefits which are being nullified or impaired as a result of Section 110(5)(B)?" or as "What is the level of benefits which would accrue to the European Communities if Section 110(5)(B) were brought into conformity with Articles 11*bis*(1)(iii) and 11(1)(ii)?"

<sup>34</sup> Article 9.1 of the TRIPS Agreement provides in pertinent part that "Members shall comply with Articles 1 through 21 of the Berne Convention (1971) and the Appendix thereto."

<sup>35</sup> Panel Report on *US - Section 110(5) Copyright Act*, *supra*, para. 6.18.

<sup>36</sup> Article 1.1 of the TRIPS Agreement makes clear that "Members shall give effect to the provisions of the [TRIPS] Agreement." Members must, therefore, implement in their domestic law the protection required by the TRIPS Agreement. Moreover, Article 1.3 of the TRIPS Agreement provides in relevant part that "Members shall accord the treatment provided for in this Agreement to the nationals of other Members." (footnote omitted) This confirms that the exclusive rights conferred by Articles 11*bis*(1)(iii) and 11(1)(ii) must be granted to EC right holders.

that, in practice, such exclusive rights are and would be exploited through licensing. The Arbitrators see no reason to differ from the parties in this regard.<sup>37</sup>

3.17 If it is assumed, then, that copyright holders exploit their exclusive rights by granting licences for the use of their works, one of the benefits which arises from those rights consists of the licensing royalties which right holders would receive. Thus, exclusive rights such as those set forth in Articles 11*bis*(1)(iii) and 11(1)(ii) will normally translate into economic benefits for copyright holders.

3.18 In their submissions to the Arbitrators, the parties have focused on this type of benefit accruing to copyright holders. The Arbitrators concur with the parties that, for purposes of these arbitration proceedings, the relevant benefits are those which are economic in nature.<sup>38</sup> This is consistent with previous decisions of arbitrators acting under Article 22.6 of the DSU.<sup>39</sup> Moreover, like the parties to this dispute, the Arbitrators will proceed on the assumption that the licensing royalties realizable by copyright holders constitute an adequate measure of the economic benefits arising from Articles 11*bis*(1)(iii) and 11(1)(ii).

3.19 Accordingly, the Arbitrators will, in this case, assess the level of EC benefits which Section 110(5)(B) is nullifying or impairing in terms of the royalty income foregone by EC right holders. In making this observation, the Arbitrators are aware that their task in this case is to determine the benefits which are denied to the *European Communities* rather than determining the benefits which are denied to *EC right holders*. However, there can be no question that the benefits which are denied to the European Communities include the benefits which are denied to EC right

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<sup>37</sup> The assumption that the exclusive rights at issue in this dispute are exploited through licensing is, of course, without prejudice to any assumptions that may appropriately be made in other cases involving other exclusive rights guaranteed by the TRIPS Agreement.

<sup>38</sup> This view is based on the object of the present proceedings, which is to quantify the economic harm suffered by the European Communities as a consequence of the continued application of Section 110(5)(B). It does not necessarily follow that Members having recourse to Article 64 of the TRIPS Agreement need to establish nullification or impairment of *economic* benefits accruing to them under the TRIPS Agreement. The Arbitrators find support for their view in the following statement by the arbitrators in *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*: "[A] Member's potential interests in trade in goods or services and its interest in a determination of rights and obligations under the WTO Agreements are each sufficient to establish a right to pursue a WTO dispute settlement proceeding. However, a Member's legal interest in compliance by other Members does not, in our view, automatically imply that it is entitled to obtain authorization to suspend concessions under Article 22 of the DSU." See the Decision of the Arbitrators on *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* (hereafter "*EC - Bananas III (22.6) (US)*"), WT/DS27/ARB, 9 April 1999, para. 6.10.

<sup>39</sup> See, e.g., the Decisions of the Arbitrators on *EC – Bananas III (22.6) (US)*, *supra*, para. 6.12 (benefits nullified or impaired: losses in US exports of goods and losses by US service suppliers in services supply); *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB/ECU, 24 March 2000, footnote 52 (benefits nullified or impaired: losses by Ecuador of actual trade and of potential trade opportunities in bananas and the loss of actual and potential distribution service supply); *European Communities - Measures Concerning Meat and Meat Products (Hormones) - Original Complaint by the United States - Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* (hereafter "*EC - Hormones (22.6) (US)*"), WT/DS26/ARB, 12 July 1999, para. 41 (benefits nullified or impaired: foregone US exports of hormone-treated beef and beef products); *European Communities - Measures Concerning Meat and Meat Products (Hormones) - Original Complaint by Canada - Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* (hereafter "*EC - Hormones (22.6) (Canada)*"), WT/DS48/ARB, 12 July 1999, para. 40 (benefits nullified or impaired: foregone Canadian exports of hormone-treated beef and beef products).

holders.<sup>40</sup> What is more, the European Communities has not made out a claim to the effect that Section 110(5)(B) is nullifying or impairing benefits additional to those which EC right holders could otherwise derive from Articles 11*bis*(1)(iii) and 11(1)(ii). As a result, it is appropriate, for the purposes of these proceedings, to determine the level of EC benefits which Section 110(5)(B) is nullifying or impairing in terms of the benefits foregone by EC right holders.

3.20 Having addressed the nature of the benefits which should accrue to the European Communities under Articles 11*bis*(1)(iii) and 11(1)(ii), the Arbitrators next turn to the issue of the *level* of benefits which the European Communities could expect to accrue to it under those Articles. Put in another way, the next issue confronting the Arbitrators relates to the level of royalty income which EC right holders could expect to receive if the United States were to comply with its obligations under Articles 11*bis*(1)(iii) and 11(1)(ii).<sup>41</sup>

3.21 The European Communities considers that, because this dispute involves exclusive rights, the level of benefits which EC right holders could expect to obtain should be assessed by reference to the economic value of the exclusive rights conferred on them by Articles 11*bis*(1)(iii) and 11(1)(ii). The European Communities argues that the economic value of those rights corresponds to the royalty income *potentially* realizable by EC right holders. The European Communities recalls, in this regard, that all US bars, restaurants and retail establishments which play radio or television music would have to pay licensing fees and that any unauthorized use of copyrighted musical works by such establishments would be illegal.

3.22 The Arbitrators are cognizant of the fact that the rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii) are in the nature of exclusive rights. If granted by the United States, those rights would provide EC right holders with the assurance that any unauthorized use of those works would be illegal as a matter of US law. It is also true, as the European Communities suggests, that any unauthorized use of copyright works, quite apart from being illegal, would deprive EC right holders of royalty income. However, the question is whether the level of royalty income which EC right holders could expect to receive *includes* the royalty income of which they would be deprived by all unauthorized users of their works.

3.23 The European Communities answers this question in the affirmative. In essence, it argues that because EC right holders *should* receive licensing royalties from *all* users of their copyright works - i.e., legal and illegal users - the benefits which the European Communities can expect to accrue to it are equal to the royalty income which EC right holders *should* receive.<sup>42</sup>

3.24 The Arbitrators consider that the benefits which they should take into account in this case are those which the European Communities could reasonably expect to accrue to it under

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<sup>40</sup> Indeed, as already pointed out, the rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii) must, in conformity with the provisions of Article 1.3 of the TRIPS Agreement, be granted to EC right holders.

<sup>41</sup> It should be noted that it is not in dispute that the level of benefits which EC right holders could expect to accrue to them if Section 110(5)(B) were brought into conformity with the TRIPS Agreement would depend, first and foremost, on the competitive position of EC right holders in the US market. As a matter of fact, both parties have attempted to estimate what percentage of total royalty income generated in the United States would accrue to EC right holders if Section 110(5)(B) were made to conform to Articles 11*bis*(1)(iii) and 11(1)(ii).

<sup>42</sup> In the European Communities' view, the royalty income which EC right holders *should* receive - i.e., the royalty income potentially realizable by EC right holders - represents the economic value of the exclusive rights at issue in this dispute. Even assuming that were correct (a question which the Arbitrators do not here decide), the Arbitrators note that they are not called on, in this case, to assess the economic value of the *rights* set forth in Articles 11*bis*(1)(iii) and 11(1)(ii). Rather, the mandate of the Arbitrators is to determine the economic value of the *benefits* which would arise from those rights on an annual basis. See document WT/DS160/15. Therefore, the Arbitrators do not find it appropriate, in the context of the present proceedings, to speak of the "economic value of the rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii)".

Articles 11*bis*(1)(iii) and 11(1)(ii).<sup>43</sup> In this regard, the Arbitrators certainly appreciate the European Communities' point that, as a matter of US law, all users of copyright works by EC right holders *should* be licensed and *should* pay licensing fees. But is it reasonable, in the circumstances of the present dispute, for the European Communities to expect that all users of the works of EC right holders *would* be licensed and *would* pay licensing fees?

3.25 In considering this issue, it is important to recall that the rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii) do not exercise or enforce themselves. In this connection, the Arbitrators note that neither party to this dispute has suggested that, in the event those rights were available under US law, the United States would have any role to play in how those rights would be exercised. Nor has it been asserted that it would be the duty of the United States to enforce those rights on behalf of EC right holders. In the view of the Arbitrators, it is clear that the exercise and enforcement of the rights conferred by Articles 11*bis*(1)(iii) and 11(1)(ii) would not be the responsibility of the United States but of EC right holders.<sup>44</sup>

3.26 Indeed, it is common ground that, in practice, copyright holders entrust CMOs with the exercise and enforcement of the exclusive rights at issue in this dispute.<sup>45</sup> Such CMOs are authorized by copyright holders to identify users of their rights, grant licences for the use of those rights and take legal action to enforce licences or pursue users who fail to seek licences.

3.27 The United States submits that, in performing the aforementioned tasks, US CMOs incur substantial costs. The United States recalls in this respect that, in the United States, the potential base of users of copyrighted musical works - i.e., bars, restaurants and retail establishments - is wide, geographically dispersed and in almost constant change, as users continually leave and enter the market. From these considerations, the United States infers that it is not economically rational for US CMOs - which the United States says generally seek to maximize profits for the right holders they represent<sup>46</sup> - to attempt to identify and obtain licences from *every* user of copyright works.<sup>47</sup>

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<sup>43</sup> It should be recalled, in this context, that the inquiry into the level of benefits which the European Communities could expect to accrue to it *if* Section 110(5)(B) were brought into conformity with the TRIPS Agreement is hypothetical in nature. The Arbitrators consider that, in such a situation, it is necessary to proceed with caution, such that only those benefits which the European Communities could, in good faith and taking account of all relevant circumstances, expect to derive from Articles 11*bis*(1)(iii) and 11(1)(ii) are found to be nullified or impaired.

<sup>44</sup> It should be mentioned, however, that the TRIPS Agreement does lay on the United States certain obligations in respect of the enforcement of intellectual property rights in its territory. Those obligations are laid down in Articles 41 *et seq.* of the TRIPS Agreement. The general obligation is set out in Article 41, which provides in relevant part that "Members shall ensure that enforcement procedures [...] are available under their law so as to permit effective action against any act of infringement of intellectual property rights covered by this Agreement [...]". Before the Panel, the European Communities did not raise a claim of violation in respect of any of the enforcement provisions of the TRIPS Agreement. See the Panel Report on *US - Section 110(5) Copyright Act*, *supra*, para. 3.2. The Arbitrators must therefore assume that the United States is acting consistently with the enforcement obligations contained in the TRIPS Agreement.

<sup>45</sup> See the Panel Report on *US - Section 110(5) Copyright Act*, *supra*, para. 2.17. EC right holders could theoretically attempt to license users of their copyright works directly, i.e., with no involvement of US CMOs. The Arbitrators consider, however, that it is justifiable, for purposes of the present proceedings, to leave out of account the possibility of direct licensing by EC right holders. From the evidence on record, it appears to the Arbitrators that, because of the very high transaction costs associated with direct licensing, it is unlikely that EC right holders would license their rights directly to a significant extent. At any rate, neither party has specifically requested that royalty income stemming from direct licensing be factored into the Arbitrators' calculation.

<sup>46</sup> The United States also points out, however, that US CMOs themselves may, in some cases, be organised as non-profit organizations. The United States notes that this is true, for example, of ASCAP.

<sup>47</sup> The United States notes that US CMOs are, in practice, most interested in licensing users from which expected revenue is greatest and expected cost of collection is least. According to the United States, US CMOs

According to the United States, estimates relating to the time before Section 110(5)(B) was enacted in fact bear out its view that right holders do not license *all* of the potential users of their works.<sup>48</sup>

3.28 The European Communities does not deny that the exercise of the exclusive rights of right holders entails costs. Nor has the European Communities specifically contested the United States' argument that it might not be economically rational for US CMOs to attempt to license each and every user of copyright works. The European Communities nevertheless considers that the costs of the administration and enforcement of exclusive rights should not be factored into the calculation of the level of EC benefits which are being nullified or impaired as a result of Section 110(5)(B). The European Communities submits that to do so would mean that, notwithstanding the TRIPS Agreement, EC right holders would have to accept a certain level of what the European Communities terms as "piracy".

3.29 The Arbitrators see force in the United States' argument that the number of users whom US CMOs will seek to license is a function of the expected cost and revenue per licence. The Arbitrators also find persuasive the suggestion that the cost and revenue per licence vary according to the characteristics of the user base, including such factors as the number, size and location of the users that play broadcast music as well as the extent to which users play such music.<sup>49</sup>

3.30 Moreover, it is clear from the information supplied by the parties on the characteristics of the US user base that US CMOs would incur very significant costs if they were to attempt to achieve licensing levels of 100%. It is quite reasonable, therefore, that US CMOs could generate greater net licensing revenues for themselves at lower levels of licensing. Indeed, the evidence on record supports the United States' claim that, in practice, US CMOs collect only a proportion of the royalty

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would, for example, be more likely to incur the cost of licensing a large department store in New York City than to incur the likely higher cost of identifying and licensing a small bar in rural Kansas.

<sup>48</sup> The United States estimates that before Section 110(5)(B) was enacted, between xx% (estimate for 1996) and 19% (estimate for 1997) of restaurants in the United States were licensed to play music. On the other hand, the United States has indicated before the Panel that approximately 74% of all restaurants in the United States play music. See the Panel Report on *US - Section 110(5) Copyright Act, supra*, Attachment 2.3 (US response to question 11(b) by the Panel to United States).

<sup>49</sup> Unlike the European Communities, the Arbitrators see nothing in paragraph 6.247 of the Panel report which would suggest that it would be inappropriate, in the circumstances and for purposes of *this* dispute, to take into consideration such factors as the transaction costs associated with licensing and the characteristics of the user base. Nor is it clear to the Arbitrators how taking account of those factors could "undermine the scope and binding effect" of the TRIPS Agreement. Paragraph 6.247 addresses the issue of whether a Member could justifiably limit the exclusive rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii) on the basis that right holders would, in terms of actual rather than potential losses, be no worse off after the introduction of the limitation than before its introduction. See the Panel Report on *US - Section 110(5) Copyright Act, supra*, para. 6.247. This is an issue which is quite different from the ones confronting the Arbitrators in this case.

Similarly, the Panel's statement in paragraph 6.196 of its report that the licensing practices of CMOs cannot necessarily be fully indicative of "normal exploitation" of exclusive rights in no way runs counter to the view of the Arbitrators that the level of licensing which US CMOs aim to achieve is a function of expected cost and revenue per licence. The issue considered by the Panel was whether the fact that the 1998 Amendment did not generally change the licensing practices of US CMOs in relation to those establishments that were already exempted under the original homestyle exemption was a reliable indicator of normal exploitation of exclusive rights. The Panel found that it was not, because it was evident that, due to the pre-existing homestyle exemption, those establishments could not be licensed. See the Panel Report on *US - Section 110(5) Copyright Act, supra*, para. 6.196. It does not follow from the Panel's finding that the costs associated with licensing have no bearing on the level of licensing. Indeed, the Panel acknowledged "[...] that the extent of exercise or non-exercise of exclusive rights by right holders at a given point in time is of great relevance for assessing what is the normal exploitation with respect to a particular exclusive right in a particular market." See the Panel Report on *US - Section 110(5) Copyright Act, supra*, para. 6.188.

income potentially realizable by right holders and that they do not license all users of copyright works.<sup>50</sup>

3.31 Contrary to the European Communities' view, taking account of the transaction costs incurred by US CMOs and of the bearing those costs have on the level of licensing does not carry the implication that right holders "have to" accept a certain level of "piracy". Right holders, or the CMOs representing them, are at liberty to seek to license all users of their works. As should be clear from the preceding paragraphs, however, were CMOs to do so, they would not necessarily maximize the royalty income of the right holders they represent.

3.32 In response to the European Communities' "piracy" argument the Arbitrators further wish to note that "piracy" is of course an emotive word when used in the context of the infringement of copyright. In areas of copyright use not covered by the exemptions provided for in Section 110(5), it would be surprising if there were now 100% collection of royalties potentially due. Before the enactment of the 1998 Amendment, it was most unlikely that all the enterprises now entitled to the benefit of the exemptions there provided for would either have been licensed or, if licensed, would have actually paid all the licensing fees which were due. But, as previously indicated, the European Communities has not formally made a claim of violation in respect of any of the enforcement provisions of the TRIPS Agreement. If the 1998 Amendment had not been passed, it seems unlikely that there would ever have been any complaint to the DSB about a failure on the part of the United States to take steps to ensure full compliance. This suggests that, at that time, the European Communities accepted the reality that there could never be 100% recovery.

3.33 In the light of the foregoing, the Arbitrators consider that the European Communities could not reasonably expect that, in the United States, all users of copyright works of EC right holders would be licensed and would pay licensing royalties. As a result, the level of royalty income which the European Communities could reasonably expect EC right holders to receive is, in the view of the Arbitrators, limited to licensing revenue from the numbers of users that *would* be licensed.

3.34 The Arbitrators are thus unable to accept the European Communities' view that the level of benefits which the European Communities could reasonably expect to accrue to it under Articles 11*bis*(1)(iii) and 11(1)(ii) equals the royalty income potentially realizable by EC right holders. Indeed, were the Arbitrators to adopt the European Communities' view, the level of EC benefits *nullified or impaired* as a result of Section 110(5)(B) would be *higher* than the level of benefits which would *actually accrue* to the European Communities if Section 110(5)(B) were brought into conformity with the TRIPS Agreement.<sup>51</sup> The Arbitrators consider that such an outcome would be both inconsistent and unwarranted. It would be quite inappropriate for the Arbitrators to award the European Communities benefits which it is not actually losing as a result of the continued application of Section 110(5)(B).<sup>52</sup>

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<sup>50</sup> The European Communities does not specifically question the accuracy of the United States' estimates of the level of licensing which would likely prevail in the United States if Section 110(5)(B) were brought into conformity with the TRIPS Agreement. On the other hand, data provided by the European Communities suggests that the level of licensing in some member States of the European Communities is significantly higher than in the United States. It should be recalled, however, that, before the Panel, the European Communities did not formally claim that the United States was acting inconsistently with the enforcement obligations contained in the TRIPS Agreement. See *supra*, footnote 44.

<sup>51</sup> This is because the royalty income potentially realizable by EC right holders -- which the European Communities suggests is what the Arbitrators should assess in this dispute -- exceeds the actual royalty income which EC right holders may reasonably be expected to realise once the United States makes available the rights referred to in Articles 11*bis*(1)(iii) and 11(1)(ii).

<sup>52</sup> For the same reason, the Arbitrators cannot agree with the European Communities that it would be absurd for the level of nullification or impairment to be lower in the case of Members with low levels of licensing (due, e.g., to high licensing costs) than it would be in the case of Members with high levels of

3.35 In conclusion, the Arbitrators will, in this case, determine the level of EC benefits nullified or impaired as a result of Section 110(5)(B) by reference to the royalty income which EC right holders could reasonably be expected to realize if the United States made available the rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii). For the reasons indicated above, the Arbitrators consider that the royalty income which EC right holders could reasonably be expected to realize does not include the royalty income which EC right holders would forego by not exercising or enforcing their exclusive rights.

#### B. ROYALTIES COLLECTED *VERSUS* ROYALTIES DISTRIBUTED

3.36 As previously indicated, there is a further and separate conceptual issue which the Arbitrators need to resolve prior to dealing with the details of how to calculate the level of EC benefits which are being nullified or impaired as a result of Section 110(5)(B). That issue goes to the question of whether the royalty income which EC right holders could reasonably be expected to realize is equal to the amount of licensing royalties which would be *collected* by US CMOs from users of works of EC right holders or whether, instead, it is equal to the amount of royalties which would be *distributed* by US CMOs to EC right holders.

3.37 The **European Communities** considers that the Arbitrators should base their determination on the amount of royalties to be paid by the users of copyright works and not on the amount of royalties which US CMOs would distribute to EC right holders. The European Communities notes that the services rendered by US CMOs to EC right holders entail costs for the latter and that these costs reduce the net proceeds of EC right holders. But the European Communities recalls its view that what has to be assessed in the present case is the value of the exclusive rights which are being denied to EC right holders. The costs which US CMOs would incur in administering the rights of EC right holders or the net proceeds accruing to EC right holders are, in the view of the European Communities, irrelevant to the assessment of the economic value of the exclusive rights of EC right holders.

3.38 The European Communities further notes that *all* economic operators incur expenses in collecting receivables because they either need to employ staff for that purpose or else use the services of specialized enterprises. The European Communities argues that, notwithstanding that, the costs related to the collection of receivables from transactions involving goods or services have never been used, in past arbitration proceedings under Article 22.6 of the DSU, to reduce the level of benefits found to be impaired or nullified as a result of an infringement of WTO obligations.

3.39 The **United States** argues that the benefits lost to EC right holders as a result of Section 110(5)(B) are the distributions they otherwise would receive from US CMOs. The United States submits that the benefits lost to EC right holders are not the gross licensing royalties the US CMOs would otherwise collect from licensed users. According to the United States, this is because US CMOs would only distribute *net* licensing royalties to EC right holders. The United States defines net licensing royalties as "licensing royalties collected by the collecting societies minus the costs incurred by the collecting societies". Those costs include the costs resulting from the collection and administration of the rights of copyright holders.

3.40 The United States adds that the European Communities, in focusing only on the payment of fees from US licensees to US CMOs, overlooks the fact that the present case is a trade case. For the United States, what matters are the cross-border payments which EC right holders should be receiving. Thus, in the view of the United States, the level of nullification or impairment suffered by the European Communities equals the foregone earnings in its current account transactions with the

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licensing (due, e.g., to low licensing costs). The level of benefits which would actually accrue to other Members would, likewise, be smaller in the case of Members with low levels of licensing than it would be in the case of Members with high levels of licensing.

United States, resulting from the inconsistency found between US law and the TRIPS Agreement. The United States recalls in this regard that the current account transaction is the distribution from a US CMO to an EC right holder, and not the payment of a fee by a US licensee to a US CMO.

3.41 The **Arbitrators** note that US CMOs do not distribute to copyright holders the total amount of licensing royalties which they collect from licensed users. This is because the CMOs have to cover the costs which they incur in licensing the rights of copyright holders as well as general operating costs. It follows that the total amount of royalties which US CMOs would distribute to EC right holders if the United States made available to them the rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii) would be smaller than the total amount of licensing royalties paid to US CMOs by licensed users of works of EC right holders.

3.42 This raises the issue of whether the level of EC benefits which are being nullified or impaired as a result of Section 110(5)(B) should be calculated on the basis of the amount of licensing royalties which would otherwise be *collected* by US CMOs from US licensees or on the basis of the amount of royalties which would be *distributed* by US CMOs to EC right holders.

3.43 In considering this issue, it is useful to take a closer look at the relationship between copyright holders, US CMOs and users of copyright works. As concerns, first, the right holders, they are linked to US CMOs by membership or affiliation agreements.<sup>53</sup> Under such agreements, right holders grant US CMOs the (nonexclusive) right to license users of their copyright works.<sup>54</sup> In return, right holders receive royalty payments from the CMOs in accordance with those societies' distribution policies and methods.<sup>55</sup> The CMOs, for their part, negotiate licensing agreements with the users of the works of right holders they represent. Those negotiations relate, in particular, to the licensing royalties to be paid by licensed users to the CMOs.

3.44 It should be clear from the preceding paragraph that when EC right holders authorize US CMOs to license their rights, they cannot reasonably expect to receive any benefits directly from the licensed users of their works.<sup>56</sup> The benefits which EC right holders, and thus the European Communities, would derive from the exclusive rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii) would be those resulting from the agreements of EC right holders with US CMOs.

3.45 In order to answer the question of what benefits EC right holders would derive from their agreements with US CMOs, it is necessary, as an initial matter, to be clear about the concept of "benefits". In this regard, the Arbitrators consider that useful guidance may be drawn from the decision of the arbitrators in *EC - Hormones (22.6) (US)*. In that case, the arbitrators determined the level of US benefits nullified or impaired as a result of the European Communities' hormone ban by reference to the total value of US beef or beef products which would have been exported in the absence of the ban.<sup>57</sup>

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<sup>53</sup> The Arbitrators note that this is true, at any rate, of the US CMOs which are relevant to this dispute, i.e., ASCAP and BMI.

<sup>54</sup> Thus, in cases where CMOs of the type at issue in this dispute are involved, there is no direct link, legal or otherwise, between right holders and licensed users.

<sup>55</sup> As already noted, US CMOs deduct the collection, administration and other costs from the licensing royalties collected before making distributions to right holders. Furthermore, it should be pointed out that US CMOs offer so-called blanket licences, which authorise licensed users to use the works of *all* right holders represented by a particular CMO. It is necessary, therefore, for the CMOs to devise distribution formulas in order to assess the royalty payments to be made to individual right holders.

<sup>56</sup> EC right holders could receive benefits directly from the users of their copyright works if they were to license those users directly. As previously noted, however, the possibility of direct licensing by EC right holders is left out of account for purposes of the present proceedings. See *supra*, footnote 45.

<sup>57</sup> See the Decision of the Arbitrators on *EC - Hormones (22.6) (US)*, *supra*, para. 43.

3.46 With this definition in mind, the Arbitrators now turn to consider what benefits EC right holders would derive from their agreements with US CMOs. As already mentioned, in exchange for granting US CMOs the right to license users, the CMOs would make royalty payments ("distributions") to right holders. It is not in dispute that the payments right holders would receive from US CMOs would be equal to the licensing royalties collected from licensed users of their works, minus the collection and other costs incurred by the US CMOs.

3.47 Like the United States, the Arbitrators are of the view that no particular significance attaches to the fact that the distributions by US CMOs amount to the net licensing revenue of US CMOs. Whatever those distributions may represent for US CMOs, for EC right holders, despite the fact that, in a sense, those distributions are net payments because of the deduction of collection and other costs, they would represent gross receipts and thus benefits resulting from the exclusive rights set forth in Articles 11*bis*(1)(iii) and 11(1)(ii).

3.48 The Arbitrators consider, therefore, that it is the total amount of royalty payments ("distributions") which US CMOs would make to EC right holders (or their representatives) that constitutes the benefits which the European Communities could reasonably expect to accrue to it under Articles 11*bis*(1)(iii) and 11(1)(ii). In more simple terms, it could be said that the benefits which the European Communities could expect to realize are the payments which US CMOs would make to EC right holders after the deduction of collection and administration costs.

3.49 It is true that the CMOs' distributions to EC right holders would be smaller in amount than the licensing royalties collected by US CMOs from users licensed to use the works of EC right holders. However, it does not follow from the fact that US CMOs would be able to *collect* a certain amount of licensing royalties from licensed users that EC right holders would, *ipso facto*, be *entitled* to receive that amount. As previously pointed out, the payments to be made by US CMOs would depend on the terms of the membership or affiliation agreements between the US CMOs and EC right holders. Under the agreements typically concluded between copyright holders and the US CMOs in question, right holders do *not* receive the full licensing fees collected by US CMOs. The Arbitrators see no reason to assume otherwise in this case.

3.50 The European Communities does not agree that the Arbitrators should determine the amount of royalty payments which US CMOs would make to EC right holders. According to the European Communities, what should be determined is the amount of licensing royalties which would have to be *paid* by users of the works of EC right holders because, in its view, that amount constitutes the value of the exclusive rights which are being denied to EC right holders. The Arbitrators are not convinced by this argument. To recall, the task of the Arbitrators in this case is to assess the level of EC benefits nullified or impaired as a result of Section 110(5)(B), and not to establish the economic value of the exclusive rights which are being denied to EC right holders.<sup>58</sup>

3.51 Even assuming, *arguendo*, the Arbitrators had to establish the economic value of the exclusive rights in question, it is clear that the economic value of those rights would need to be assessed at the level of EC right holders, given that the object of these proceedings is to assess the economic impact of Section 110(5)(B) on the European Communities. For the reasons set out in the preceding paragraphs, the "potential licensing revenue"<sup>59</sup> which could be realized by EC right holders licensing their rights through US CMOs would *not* correspond to the licensing royalties which US licensees would pay to US CMOs.

3.52 The United States considers that the benefits lost to EC right holders as a result of Section 110(5)(B) are the distributions they otherwise would receive from US CMOs. The

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<sup>58</sup> See also *supra*, footnote 42.

<sup>59</sup> It will be recalled that the European Communities considers that the economic value of the exclusive rights in question is equal to the potential licensing revenue realizable by EC right holders.

United States notes that the distributions from US CMOs to EC right holders are reflected on the US current account of international payments. The United States submits, therefore, that the level of EC benefits nullified or impaired should be measured as foregone earnings in the European Communities' current account transactions with the United States.

3.53 The Arbitrators are not persuaded that it is necessary, or even appropriate, in this case to link the issue of the level of EC benefits which are being nullified or impaired to the US current account of international payments. To begin with, the Arbitrators do not see any legal reason why the calculation of the level of payments from US CMOs to EC right holders should necessarily be based on figures stemming from the US current account. The fact that the current account may, in some cases, be usefully relied on to measure the impact of WTO-inconsistent measures does not lead to the conclusion that the current account should be determining in all cases or that it should be used to the exclusion of other sources of relevant data.<sup>60</sup> Indeed, the United States itself has not based its argumentation before the Arbitrators on current account figures, nor has it provided such figures to the Arbitrators.

3.54 Another reason for approaching current account figures with caution in this case lies in the fact that they may not give sufficiently accurate indications regarding the amount of payments which US CMOs would make to EC right holders. It is the understanding of the Arbitrators that the international transactions which are reflected on the US current account are transactions between residents of the United States and foreign residents. In other words, it is the residency of the parties involved in a particular cross-border transaction rather than their nationality which determines whether and, if so, where that transaction is reflected on the current account. However, what the Arbitrators are concerned with in the present proceedings are payments made by US CMOs to EC nationals, i.e., EC right holders.<sup>61</sup>

3.55 Thus, payments made by US CMOs to EC right holders residing in the United States or to EC right holders residing in, say, Switzerland should, in the view of the Arbitrators, be taken into account in their determination of the level of EC benefits which are being nullified or impaired. Yet those transactions would not be reflected on the US current account as transactions between the United States and the European Communities because the EC nationals concerned would not be EC residents.

3.56 A similar problem would arise in the event of indirect distributions from US CMOs to EC right holders. For instance, EC right holders might rely on US publisher affiliates to represent them in the United States. In such cases, the relevant payments would be those from US CMOs to US publisher affiliates representing EC right holders. These types of payments from US CMOs to US publisher affiliates would not be reflected on the US current account. Yet this does not alter the fact that such payments would be payments to EC right holders.<sup>62</sup> As such, the Arbitrators must take them into account.<sup>63</sup>

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<sup>60</sup> In the view of the Arbitrators, the mere fact that this case is a "trade case" involving international licensing payments which appear on the US current account does not, in itself, provide a sufficient rationale for why current account figures have to be utilised.

<sup>61</sup> Article 1.3 of the TRIPS Agreement requires Members to accord the treatment provided for in that Agreement to the "nationals of other Members".

<sup>62</sup> In the view of the Arbitrators, such royalty payments would be payments to EC right holders even if EC right holders decided to use or reinvest their revenue in the United States rather than to have it transferred to a member State of the European Communities.

<sup>63</sup> The Arbitrators note that the data they have been provided with concerning distributions by the US CMOs to EC right holders through their US publisher affiliates is somewhat incomplete in that it does not specify the criteria which were applied in compiling it. In the view of the Arbitrators, the data supplied might include distributions to persons that could be considered to be US right holders. The Arbitrators explain at para. 4.46 how they have taken account of this problem in determining the level of such indirect distributions.

3.57 As is evident from the aforementioned examples, were the Arbitrators to employ current account figures, there would be a risk of underestimating the payments which US CMOs would make to EC right holders.<sup>64</sup> In view of that risk, the Arbitrators prefer not to base their determination of the level of benefits lost by the European Communities on data taken from the US current account.<sup>65</sup>

3.58 In the light of the above considerations, the Arbitrators conclude that the level of EC benefits which are being nullified or impaired as a result of Section 110(5)(B) should be assessed on the basis of the amount of royalty payments ("distributions") which would be made by US CMOs to EC right holders or their representatives.

#### IV. CALCULATION

##### A. OUTLINE OF THE METHODOLOGY FOLLOWED BY THE ARBITRATOR

##### 1. "Bottom-up" versus "top-down" approach

4.1 The Arbitrators recall that, during the proceedings before the Panel, each of the parties suggested a different approach to the calculation of the level of EC benefits nullified or impaired as a result of the operation of Section 110(5)(B). One, referred to as the "bottom-up" approach, was advocated by the European Communities.<sup>66</sup> The other one, called the "top-down" approach, was supported by the United States.<sup>67</sup> The Panel did not take position on which one was the most appropriate to determine the level of nullification or impairment of EC benefits.<sup>68</sup> Before the Arbitrators, the parties elaborated on their respective approaches, which are briefly summarized below.

4.2 Under the "bottom-up" approach, the **European Communities** takes as its starting-point the number of establishments that may qualify for the exemption. Second, the European Communities makes a reduction from that number using the US hypothesis that xx% of all eating and drinking establishments with a surface area below 3,750 square feet actually play music from the radio. Third, it applies to the remaining establishments the appropriate licensing fees selected from the licensing schedules of ASCAP and BMI. The European Communities reaches a level of nullification or impairment of benefits of US\$25,486,974.

4.3 Under the "top-down" approach, the **United States** takes as its starting-point the three-year average (1996-1998) of the total royalties paid to EC right holders by ASCAP and the total paid by BMI to EC right holders in 1996. Thereafter, it proceeds through successive deductions. It identifies the amount attributable to general licensing. Then it makes a deduction to account for licensing revenue from general licensees that do not meet the statutory definition of an "establishment". Thereafter, it deducts from the licensing revenue the portion that is due to music from sources other than radio and television. Finally, it reduces this amount to account for licensing revenue of eating, drinking and retail establishments which play the radio but do not meet the size and equipment limitations of Section 110(5)(B) and thus do not qualify for that exemption. The United States reaches a level of nullification or impairment of benefits of US\$446,000 to US\$733,000.

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<sup>64</sup> Since the Arbitrators have not been provided with information concerning the number of EC right holders residing outside the European Communities or concerning the portion of distributions by US CMOs to US publisher affiliates which the latter would actually transfer to EC right holders, they have no way of knowing whether reliance on current account figures would lead to significantly inaccurate results.

<sup>65</sup> The Arbitrators recall that, in any event, the United States has failed to provide US current account figures which would allow the Arbitrators to measure the European Communities' lost earnings.

<sup>66</sup> See the Panel Report on *US - Section 110(5) Copyright Act*, *supra*, paras. 6.253 and 6.256.

<sup>67</sup> *Ibid.*, paras. 6.252 and 6.255.

<sup>68</sup> *Ibid.*, para. 6.254.

4.4 The **Arbitrators** carefully examined the claims, arguments and evidence submitted by the parties in light of the rules on burden of proof applicable in the context of arbitrations under Article 22.6 of the DSU, as instructed by the parties. The Arbitrators were mindful of the fact that, in arbitration proceedings under Article 22.6, a party contests the level of countermeasures which the other intends to take under paragraphs 2, 3 and 4 of Article 22. It is therefore understandable that the burden be on the party that contests the level of countermeasures to make a *prima facie* demonstration that the methodology and the calculations submitted by the party intending to apply countermeasures are inconsistent with the requirements of Article 22 of the DSU. For instance, in the *European Communities - Hormones* cases, the initial burden was on the European Communities. The present case, however, was referred to the Arbitrators by both parties "by mutual agreement". It is arguable whether or not there is a complainant and a defendant. This said, we note that the agreed procedures submitted by the parties<sup>69</sup> expressly instruct us to follow the allocation of the burden of proof applied in arbitrations under Article 22.6. We also note that the parties agreed that the European Communities would submit a methodology paper ahead of the first written submissions, as in proceedings under Article 22.6. As a result, the Arbitrators decided to allocate the burden of proof accordingly, as in an Article 22.6 case.

4.5 Based upon the record before them, in particular arguments and evidence by the United States demonstrating that the EC methodology was not always appropriate, the Arbitrators consider that the United States established a *prima facie* case that the methodology and estimates proposed by the European Communities did not result in an appropriate reflection of the level of EC benefits which are being nullified or impaired. In our view, the European Communities failed to rebut this presumption. Therefore, we were not able to accept the methodology proposed by the European Communities.<sup>70</sup> We were more convinced by the US alternative. However, we did not accept all the adjustments and deductions made by the United States. In some instances we found them inappropriate and we generally attempted to make a more complete analysis. We further note that, at the request of the Arbitrators, the European Communities and the United States confirmed that the Arbitrators were not bound to choose between the EC or the US methodology, but could develop their own methodology and make their own estimates, on the basis of all arguments and evidence submitted by the parties. Therefore, while using essentially the US methodology, we applied some elements of the EC methodology and estimates in our calculations and made assessments of our own.

4.6 In that context, and having regard to our conclusions in Section III above, we applied the "top-down" approach for the following reasons.

4.7 It is appropriate to start from the number of establishments actually licensed at the time of the entry into force of the 1998 Amendment because this approach offers the advantage of providing us with a starting point grounded on historical, verified facts, even if adjustments may have to be made to assess the level of benefits nullified or impaired on the date of referral of the matter to the Arbitrators.

4.8 This approach also has the advantage of limiting the number of assumptions necessary. In comparison, the European Communities approach would require, in our view, that we base our calculation on what has been described in some Article 22.6 arbitrations as a "counterfactual".<sup>71</sup> We

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<sup>69</sup> See WT/DS160/15.

<sup>70</sup> See *supra*, Section III.

<sup>71</sup> I.e., the approach followed for instance in *EC - Hormones (22.6) (US) and EC - Hormones (22.6) (Canada)*, where, in the absence of trade figures relating to a period where the EC regime could be deemed to be WTO-compatible, the arbitrators had to assess what the amount of trade would have been if the European Communities had brought its legislation into conformity at the end of the reasonable period of time it had been granted to do so. In its first submission, the European Communities also claims that the absence of proper protection, even before the 1998 Amendment, of the rights that Section 110(5)(B) denies makes it impossible to look, for comparison purposes, at a historical TRIPS-compatible situation. The European Communities adds

believe that recourse to a counterfactual would only be justified if it was established that the situation predating the 1998 Amendment was itself TRIPS-incompatible.

4.9 The Arbitrators recall that, before the entry into force of the 1998 Amendment, some categories of establishments were already exempted from copyright payments under Section 110(5) of the 1976 Copyright Act. To be exempted, these establishments had to use a single receiving apparatus of a kind commonly used in private homes, hence the term "homestyle exemption" used to describe it.<sup>72</sup> Some size requirements also applied to the establishments, based on decisions of courts.<sup>73</sup> With the 1998 Amendment, a subparagraph (B) was added which extended the scope of exemptions under Section 110(5).<sup>74</sup>

4.10 The Arbitrators note that their task is to determine the level of EC benefits nullified or impaired, not to assess the TRIPS-compatibility of any piece of US legislation. Within that framework, they also consider that the most appropriate way to assess the level of EC benefits nullified or impaired is to determine what EC right holders received before the enforcement of the 1998 Amendment – because historical figures are available with respect to that period - and adjust it as appropriate to take into account the evolution of the US market in the sector concerned.

4.11 The Arbitrators are mindful that they should base their calculation on a TRIPS-consistent situation. They recall that the European Communities has claimed that the situation pre-dating the 1998 Amendment (i.e. the exemption of certain establishments under the original homestyle exemption) was not TRIPS-compatible. The European Communities bases its conclusion on the fact that, in its view, the incompatibility of Section 110(5)(B) implies that the original homestyle exemption itself was TRIPS-incompatible.

4.12 The Panel did not make any finding on the original homestyle exemption which, in any event, was no longer in force by the time it issued its report. However, in its analysis of the current Section 110(5)(A) and (B), the Panel did make a number of statements relating to the original homestyle exemption. The Arbitrators recall that the Panel noted the limited percentage of establishments covered by the original homestyle exemption, the restrictions imposed by Section 110(5) and, more specifically, the fact that "playing music by the small establishments covered by the exemption by means of homestyle apparatus has never been a significant source of revenue collection for CMOs."<sup>75</sup> We note in this respect that the European Communities did not, either before the Panel or during these proceedings, sufficiently establish its claim that the economic impact of the original homestyle exemption was considerable.

4.13 The Arbitrators, having regard to the reasons stated by the Panel, concluded that, *even if* the situation pre-dating the 1998 Amendment was TRIPS-inconsistent (a question the Arbitrators do not decide), the impact on the level of EC benefits nullified or impaired of relying on figures excluding those establishments which benefitted from the original homestyle exemption would be limited. Comparatively, trying to take into account in our calculations those establishments which were subject to the original exemption would require further estimates, and applying the EC methodology would involve more assumptions and inferences.

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that it "had to base its assessment on an 'as-if' basis drawing from other similar situations under US Copyright law and its enforcement."

<sup>72</sup> Section 110(5) of the 1976 US Copyright Act will hereafter be referred to as the "original homestyle exemption".

<sup>73</sup> For a description of the situation before the 1998 Amendment, see the Panel Report on *US – Section 110(5) Copyright Act, supra*, paras. 2.5 to 2.7.

<sup>74</sup> For a description of the situation after the 1998 Amendment, see the Panel Report on *US – Section 110(5) Copyright Act, supra*, paras. 2.3, 2.8 to 2.17.

<sup>75</sup> Panel Report on *US - Section 110(5) Copyright Act, supra*, para. 6.271.

4.14 For these reasons, we considered it appropriate not to attempt to include into the total fees paid in relation to EC works the potential revenue from establishments covered by the original homestyle exemption.

4.15 Finally, we note that determining the level of nullification or impairment suffered by a Member requires detailed calculations.<sup>76</sup> In this case, the Arbitrators have encountered particular difficulties due to the lack of precise information available. This problem originated either in the actual absence of specific data for the type of transactions concerned (payment of royalties to EC right holders) or in the lack of co-operation on the part of some of the private entities which may have had the information. The absence of sufficiently specific information played a major role in the choices made by the Arbitrators with respect to the methodology and the calculations. Indeed, since they considered it more appropriate to use figures grounded on facts than deductions or inferences, the Arbitrators generally gave preference to approaches which relied as much as possible on historical figures.

## 2. Point in time at which benefits nullified or impaired should be assessed

4.16 The **European Communities** claims that it bases its assessment of nullification or impairment on a static situation based on the most recent figures available. In addition, the European Communities claims that the Arbitrators should assess nullification or impairment at the date the United States should have brought Section 110(5) into conformity with its obligations under the TRIPS Agreement.

4.17 The **United States** bases its calculation on the situation pre-dating the 1998 Amendment. Moreover, it suggests that compensation be based on trade over the 1996-1998 period. However, the United States is of the opinion that the date on which the Panel should assess the level of nullification or impairment of benefits should be the date on which the matter was referred to the Arbitrators.

4.18 In the light of the arguments of the parties, the **Arbitrators** believe that they may have to set a date on which the level of nullification or impairment of EC benefits should be assessed. Indeed, such a level may have varied over time. We note, in this respect, that the circumstances of this arbitration may justify that we adopt a different approach from that followed by arbitrators in arbitrations pursuant to Article 22.6 of the DSU.

4.19 The Arbitrators note that they have been appointed under Article 25 of the DSU. As a result, they do not feel constrained by a number of obligations imposed on arbitrators in Article 22.6 proceedings. Unlike Article 22.6, which closely relates to compliance (or absence thereof) at the end of the reasonable period of time, Article 25 is silent as to the date on which a matter referred to arbitration should be assessed. However, the Arbitrators are aware that they are not called upon to consider the level of EC benefits which may still be nullified or impaired after the end of the implementation period, but to consider the level of EC benefits which are being nullified or impaired as a result of the current application of Section 110(5)(B).<sup>77</sup> General practice under the DSU has been to consider the facts of a case as at the date of establishment of the panel. In the absence of any specification in our mandate, we believe that it should be assumed that the parties wanted us to assess the level of benefits nullified or impaired on the date the matter was referred to us. In other words, we

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<sup>76</sup> See the Decision of the Arbitrators on *Brazil – Aircraft (22.6)*, *supra*.

<sup>77</sup> This seems to imply that the level of nullification or impairment that the Arbitrators will assess in this case may be different from that which may exist after the end of the reasonable period of time. This implies further that the amount which will be determined by the Arbitrators may not dispense the parties from an Article 22.6 arbitration.

must determine the level of nullification or impairment of EC benefits over a one-year period ending as closely as possible to 23 July 2001.<sup>78</sup>

4.20 The Arbitrators recall that the European Communities suggested that they follow the approach in the *EC - Hormones* Article 22.6 arbitrations, which would consist of assessing the level of nullification or impairment of benefits in this case on the date when the United States should have brought its legislation into conformity with its WTO obligations. We recall that, in *EC - Hormones*, the arbitrators used a counterfactual and considered that they should assess the level of nullification or impairment of benefits as if the European Communities had brought its legislation into conformity at the end of the reasonable period of time.<sup>79</sup> In the present case, the reasonable period of time was supposed to lapse on 27 July 2001.<sup>80</sup> However, on 24 July 2001, the DSB agreed to an extension until 31 December 2001 or the date on which the current session of the US Congress adjourns, whichever is earlier.<sup>81</sup> In those circumstances, the Arbitrators believe that using the date of the end of the reasonable period of time as cut-off date is not feasible, lest they will add uncertainty to their estimate by making additional assumptions as to the situation at the end of a period which, itself, is not known for sure.

4.21 The Arbitrators also note that the United States claims that we should "make a finding of nullification or impairment based on data from a recent period of time (1996-1998). The parties could then ensure equivalence of the future suspension (or mutually agreed compensation) by using the same period of time in calculating the trade to be adjusted." The United States adds that "by using trade data from the same historical period used in the analysis of harm to compute what concessions should be suspended (or granted as compensation), we can compare commensurate data and minimize the need for speculation."

4.22 The Arbitrators are mindful that their approach may entail adjustments on the basis of deductions or inferences. However, we are of the view that the US approach would be incompatible with what we believe is our mandate, i.e., to assess the level of EC benefits which were being nullified or impaired *at the time the matter was referred to arbitration*.

4.23 With regard to adjustments, the Arbitrators are well aware that they should either use the most recent data available or make appropriate adjustments to reflect the evolution of the market. We note that the United States cautioned us against such adjustments, suggesting that the increase in revenues and distributions posted by ASCAP from 1998 to 2000 – the only figures available for this particular sector - may not reflect accurately the increase in EC right holders' royalties. We agree with the US concern that ASCAP's figures may not reflect the reality of the situation of EC right holders and that other factors may have contributed to ASCAP's increased revenues and distributions. As a result, we will adjust the value of EC right holders' revenue determined on the basis of historical figures by a percentage representative of the annual rate of growth of the US gross domestic product between 1998

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<sup>78</sup> The reason for the choice of a yearly basis is essentially because compensations or suspensions of concessions or other obligations have been so far calculated on a twelve-month basis.

<sup>79</sup> See the Decision of the Arbitrators on *EC – Hormones (22.6) (Canada)*, *supra*, where the arbitrators stated, at para. 37, that:

"Upon careful consideration of the claims and arguments set forth by the parties, we consider that our starting-point is as follows: what would annual prospective Canadian exports of hormone-treated beef and beef products to the EC be if the EC had withdrawn the ban on 13 May 1999? 13 May 1999 is the date of expiration of the reasonable period of time granted to the EC to implement the panel and Appellate Body reports." (Emphasis in the original).

The arbitrators made the same statement at paragraph 38 of the Decision of the Arbitrators on *EC - Hormones (22.6) (US)*, *supra*.

<sup>80</sup> See WT/DS160/13.

<sup>81</sup> DSB meeting of 24 July 2001, WT/DSB/M/107, p. 13.

and 2001, in order to reflect the evolution in the value of EC rights until the date of referral of the matter to arbitration. We consider that this approach does not contradict our original intent to base our estimate as much as possible on historical figures for two reasons:

- (a) adjusting relevant figures regarding the period pre-dating the 1998 Amendment to take into account the evolution of the US market is a necessity since that period has been one of sustained economic growth for the United States. In addition, we have been given no valid reason why we should not make that adjustment; and
- (b) using the annual rate of growth of the US gross domestic product between 1998 and 2001 is, in our opinion, a very conservative approach if one compares those figures with those supplied by ASCAP for the same period.

4.24 For these reasons, the Arbitrators deem it appropriate to calculate the level of EC benefits nullified or impaired by the continuing operation of Section 110(5)(B) on a date as close as possible to the date on which the matter was referred to them. In this case, because of the statistical information available, their estimate will be based on the situation on 30 June 2001. For the first six months of the year 2001, we have used the growth rate of 1.7%, which we have calculated from quarterly GDP at current dollar value, seasonally adjusted at annual rates as published by the US bureau of census.<sup>82</sup>

### 3. Elements not considered in the calculation

- (a) Approach of the Arbitrators

4.25 In its submissions, the **European Communities** suggested that a number of factors which, in its view, could contribute to nullification or impairment of benefits, be disregarded by the Arbitrators because precise data are lacking. This is the case of the detrimental effects of the denial of protection of specific rights in a given work for the exploitation of other rights in this work. Moreover, the European Communities only took into account in its calculations those establishments that use broadcast music (i.e. radio or television music). Despite the fact that, in its opinion, Section 110(5)(B) is also applicable to music transmitted via the Internet, the European Communities did not include this aspect in its calculations.

4.26 In the opinion of the **Arbitrators**, this raises the question of how to reconcile these suggestions with their attempt to reach an estimate which reflects as closely as possible the level of EC benefits nullified or impaired. The Arbitrators recall that in document WT/DS160/15, the parties stated that "they shall accept [the award of the Arbitrators] as the level of nullification or impairment for purposes of any future proceedings under Article 22 of the DSU in this dispute". This seems to imply that our award may not only condition the amount of compensation which the United States may offer to the European Communities under Article 22.2 of the DSU, but also the work of potential arbitrators under Article 22.6, since the latter are required under the DSU to determine whether the level of suspension of concessions or other obligations is *equivalent*<sup>83</sup> to the level of nullification or impairment of benefits.

4.27 As a result, the Arbitrators shall ensure that their determination of the level of nullification or impairment of benefits does not lead to a situation where potential EC suspensions of concessions or

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<sup>82</sup> See *infra*, para. 4.72.

<sup>83</sup> On the notion of "equivalence", see the Decision of the Arbitrators on *EC – Bananas III (22.6) (US)*, *supra*, paras. 4.1-4.8.

other obligations under Article 22.7 would be in fact "punitive", because the level of EC benefits nullified or impaired by the operation of Section 110(5)(B) would have been overestimated.<sup>84</sup>

4.28 More generally, as mentioned in paragraphs 4.15 *supra* and 4.36 *infra*, the Arbitrators in this case did not have sufficiently specific information and either had to adjust figures or draw inferences. They believe that by trying to incorporate in their calculations elements for which information was insufficient, they run the risk of erring on the side of pure speculation. Therefore, the Arbitrators considered appropriate to accept most of the "simplifications" suggested by the European Communities, such as the exclusion of indirect harm to EC copyright holders or the exclusion of music broadcast through the Internet, provided they were accepted by the United States and to the extent that, in the opinion of the Arbitrators, they did not lead to a higher level of nullification or impairment of benefits. Likewise, when they proceeded to necessary adjustments or deductions, in the absence of figures grounded on facts, the Arbitrators tried to use estimates which were accepted by the parties or otherwise seemed reasonable on the basis of the information available.

(b) Elements not considered in the calculation

(i) *"Indirect" or "potential" harm to other rights of EC right holders*

4.29 The **European Communities** recalls that the Panel pointed out that the denial of protection of specific rights in a given work can also have detrimental effects for the exploitation of other rights in this work such as substitution between different uses of the work by a given establishment or a possible erosion of licensing fees for other users. However, the European Communities, given the lack of quantitative data and the uncertainty of causality relations, suggested that the Arbitrators' assessment may not include this "potential" or "indirect" harm to other copyright sources.

4.30 The **United States** did not comment.

4.31 The **Arbitrators** are mindful of the remarks of the Panel that the denial of protection of specific rights in a given work could also have an impact on the exercise of other rights.<sup>85</sup> However, having regard to the arguments of the European Communities and in the light of their own preliminary comments above, the Arbitrators agreed not to incorporate into their calculation the "indirect" or "potential" harm caused to right holders through the substitution of broadcast music by other forms of music, such as recorded music. We consider that we have no reason not to accommodate the request of the European Communities. In particular, we believe that trying to assess the level of benefits nullified or impaired as a result of "indirect" or "potential" harm would most probably entail more assumptions, deductions or inferences, thus increasing the risk of reaching an unreasonable estimate.

4.32 The Arbitrators would like to stress, however, that their position is based on the factual circumstances of this case and the particular purpose of these proceedings, i.e., determining the level of nullification or impairment of EC benefits, not identifying violation. It is without prejudice to whether this type of damage would be considered to nullify or impair benefits accruing directly or indirectly to any Member in another case.

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<sup>84</sup> The legal consequences of an overestimation in the case of compensation under Article 22.2 of the DSU are less, since it is not specified that the compensation to be offered should be equivalent to the level of nullification or impairment. Article 22.2 of the DSU simply refer to compensation that is "mutually acceptable".

<sup>85</sup> See the Panel Report on *US - Section 110(5) Copyright Act, supra*, paras. 6.127, 6.198 and 6.239-6.240.

(ii) *Activities of SESAC*

4.33 The **Arbitrators** recall that, in the United States, three collective management organizations collect fees for copyright holders: ASCAP, BMI, and SESAC. They note that, in their submissions, the parties did not include any data relating to the activities of SESAC. The parties explained in the course of the proceedings that this was essentially because SESAC does not represent any significant number of EC collecting society members and does not distribute significant amounts of royalties to EC right holders.

4.34 We see no reason to put in doubt the information given by both parties about SESAC's representation of EC right holders. Furthermore, considering the difficulties which we would have encountered in assessing the contribution of SESAC, we have decided not to seek to factor SESAC's activities in our calculation. In that case, the reason was nevertheless more related to the limited impact that the exclusion of SESAC would, in the opinion of both parties, have on our calculation.

(iii) *Music broadcast through Internet*

4.35 The **Arbitrators** recall that the European Communities, while hinting at the impact of music transmission via Internet in the nullification or impairment of EC benefits, did not include such transmission in its calculation. The Arbitrators are aware of the development of music transmission via Internet. They note, however, that the parties and the Panel essentially addressed the question of transmission via radio or television. For the Arbitrators to ascertain the application of Section 110(5)(B) to broadcasts of music via Internet would require additional findings which, in the light of the position adopted by the European Communities, are not necessary. As a result, the Arbitrators did not consider music broadcast through Internet in their calculation.

B. CALCULATION

1. General observations

4.36 Before moving to the calculation of the level of EC benefits which are being nullified or impaired, the **Arbitrators** note that their ability to make an accurate calculation has been limited by the fact that the data provided to them by the two parties were incomplete and included many estimations and assumptions. In their submissions, both parties have recognized this problem, noting that some of the relevant data are in the possession of private parties. As explained above, we sent letters to the two main US CMOs, ASCAP and BMI, requesting actual data on their collections and distributions that would have enabled us to base our calculations on specific information. In response to those letters, we obtained some information from BMI, but due to the conditions attached to its use, we decided not to include it in the record of the case.<sup>86</sup> We also received information from ASCAP and a second submission from BMI. However, having noted that the parties favoured a prompt issue of our award, we decided for the reasons stated *supra* not to take this information into account.<sup>87</sup> Hence, we have had to work on the basis of the incomplete data provided to us by the parties.<sup>88</sup> In order to discharge the mandate given to us by the parties, and in the absence of some important data, we have had to make ourselves a number of estimations and, in some cases, make certain assumptions based on what we perceived to be the most reasonable estimate in the light of the arguments of the parties. In doing so, we have attempted to arrive at a number that is in the right order of magnitude, but we recognize that it may not be entirely accurate.

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<sup>86</sup> See *supra*, para. 1.10.

<sup>87</sup> See *supra*, para. 1.13.

<sup>88</sup> To the extent the parties have submitted data to us on a confidential basis, we have not included that data into the following explanation of our calculation. In those cases, only the results of the various steps in our calculation have been indicated.

4.37 We have discussed *supra* the differences between the methodologies suggested by the European Communities and the United States, and the implications that these differences have. We recall that the outcomes of the parties' calculations based on their respective methodologies are quite far apart from each other. The European Communities arrives at the figure of US\$ 25,486,974 per year, while the United States suggests that the level of nullification or impairment of benefits to the EC is in the range of US\$ 446,000 to US\$ 733,000 per year. This discrepancy can, to a large extent, be explained by the conceptual differences between the two approaches.<sup>89</sup>

4.38 As regards the order of magnitude of the annual losses to EC right holders resulting from Section 110(5)(B), we note as an illustration that, according to the information provided by the United States, the total domestic receipts of ASCAP - the biggest of the US CMOs - were over the period 1997-1999 US\$ 358,428,000, 377,733,000, and 422,962,000 per year; the growth in the total revenue in 1998 was 5.4% and in 1999 12%. The receipts from the general licensing area, which includes restaurants, bars, retail establishments as well as certain other establishments, in the same years were, respectively, US\$ 67,324,000, 68,032,000, and 69,695,000 per year; the growth in these receipts in 1998 was 1.05% and in 1999 2.4%. These figures indicate that, after the entry into force of the 1998 Amendment, there has not been any dip in ASCAP's total domestic receipts or even in the receipts from the general licensing category. Lacking specific data on the receipts originating from the types of establishments that were affected by the 1998 Amendment (which receipts are included in the broader general licensing category), we nonetheless note that the available data would not support an assumption that there was a significant drop in the licence fees collected from the affected areas. At the same time we note that the rate of increase of the receipts from the general licensing area was modest at a time when the US economy was expanding fast. Furthermore, the receipts from this area grew at a clearly lower rate than the total domestic receipts.

4.39 For the reasons explained *supra*,<sup>90</sup> we have adopted a "top-down" approach as suggested by the United States. Using this approach we have used the historical data on collections prior to the 1998 Amendment that have been available to us. We now proceed to calculate the level of EC benefits which are being nullified or impaired as a result of Section 110(5)(B) on this basis.

## **2. Total royalties paid to EC right holders**

4.40 In their calculation, the Arbitrators have attempted to estimate the amount of royalties that EC right holders received, prior to the entry into force of the 1998 Amendment, for the use of broadcast music from the types of establishments that were newly exempted by that Amendment. For that purpose, we have used the historical data available to us regarding the receipts of the two biggest US CMOs to whom EC right holders have entrusted the licensing of their rights - ASCAP and BMI. As we have noted before, both parties consider that the amount of royalties paid to EC right holders by the third US CMO, SESAC, is insignificant.<sup>91</sup> Therefore, we have not included its receipts into our calculations.

4.41 Relying on this historical data means that our calculation takes into account the licensing income from those establishments that used broadcast music at that time and had acquired a licence from ASCAP or BMI. Our calculation does not include any hypothetical amount of royalties from those establishments that did play broadcast music but had not acquired a licence from the CMOs in question.<sup>92</sup> Relying on the historical data means also that our calculation does not include any hypothetical revenue from such small establishments that were already exempted by the original

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<sup>89</sup> See, in particular, our discussion at paras. 3.20 *et seq.* of how the two calculations take into account the level of licensing.

<sup>90</sup> See *supra*, paras. 4.7 to 4.15.

<sup>91</sup> See *supra*, section IV.A, paras. 4.33-4.34.

<sup>92</sup> See *supra*, paras. 3.20-3.35.

homestyle exemption at the entry into force of the 1998 Amendment. For the reasons stated above<sup>93</sup>, we did not find it necessary to include such establishments in our calculation.

4.42 The **European Communities** provided us with a compilation of quantitative data by ASCAP which includes, for the years 1996-1998, first the amounts of the total domestic distribution to EC CMOs and second distribution to US publisher affiliates for performance of EC works.<sup>94</sup> The European Communities refers to these two categories as, respectively, "direct" and "indirect" distributions to EC right holders. The European Communities notes that the first category does not include the total royalties paid for EC works in the repertoire of ASCAP, because music publishers' share of royalties is overwhelmingly paid directly by ASCAP to EC publishers' US affiliates, rather than through the affiliated EC collecting societies to those EC publishers that are members of those societies. These payments to EC publishers' US affiliates are included in the second category.

4.43 The **United States** has used the three-year averages of these figures provided by ASCAP as the starting-points for its calculations, the "direct" distributions representing the lower range of royalties paid to EC right holders and the sum of "direct" and "indirect" distributions representing the upper range.

4.44 In calculating the amount of revenue that EC right holders received from ASCAP prior to the 1998 Amendment, the **Arbitrators** have taken as their starting-point the sums of "direct" and "indirect" distribution to EC right holders over the period 1996-1998.

4.45 The Arbitrators note that the 1998 Amendment entered into force on 26 January 1999. Therefore, the Amendment did not affect ASCAP's revenues collected before the year 1999. We note that the European Communities and the United States have provided us with relevant data on ASCAP's distributions to EC right holders over the three-year period of 1996-1998, and that the United States has used the average of the distributions in these three years as the starting-points for its calculation. As we are calculating the level of EC benefits nullified or impaired by the Amendment on the basis of historical data, we need to determine an appropriate previous representative period as the starting-point for our own calculation. In this regard, we note that under GATT practice the most recent three-year period not distorted by restrictions has been used in assessing the consistency of a measure.<sup>95</sup> In our case, the most recent representative period would be the three-year period not affected by the 1998 Amendment, namely the years 1996-1998. We believe that using the data made available to us for this three-year period is consistent with the prudent approach which we have decided to follow by using the "top-down" methodology based on historical figures. In determining a single starting-point for our further calculation, we have used the average of the figures concerning these three years. On the one hand, we do note that in this case ASCAP's distributions to EC right holders grew regularly over this period. On the other hand, we have no evidence that this growth is applicable also to the sector at issue in this case and, in any event, three years are generally considered to be insufficient to establish a particular trend in a market. In this sense, using an average for this three-year period would tend to reflect the average revenue at the level of the year 1997 rather than in 1998. We have taken this into account at the final step of our calculation when we have adjusted the outcome of our calculation to reflect the situation at the time of the referral of the issue to the Arbitrators.

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<sup>93</sup> See *supra*, section IV.A.

<sup>94</sup> Exhibit EC-15 (exhibit US ARB-5), which contains information that was provided to the European Communities in confidence with the request that it not be communicated to private parties.

<sup>95</sup> See the Panel Report on *EEC - Restrictions on Imports of Apples from Chile*, BISD 27S/98, adopted 10 November 1980, para. 4.8. See also the Decision of the Arbitrators on *EC - Bananas III (22.6) (US)*, *supra*, paras. 5.24 *et seq.*

4.46 The three-year average of ASCAP's distributions to EC right holders amounts to approximately US\$ xxxxxxxx per year. We note that this figure may not be entirely accurate, given that the information made available to us by the parties, on which we based our calculation, may not be complete for the reasons discussed below. Earlier we have noted that direct payments by the US CMOs to EC right holders (i.e., payments that ASCAP and BMI make directly to EC right holders that are their members rather than payments they make to EC CMOs) are relevant for our calculation even if the EC right holders in question were to collect these fees through their US affiliates.<sup>96</sup> However, as regards the confidential data on ASCAP's distributions to EC right holders' US publisher affiliates, we note that we do not have the exact criteria that ASCAP has used in producing its figures. Therefore, there may be a risk that a small part of this figure may represent payments to persons that could not be considered as EC right holders or their representatives. On the other hand, we note that neither the first nor the second category appears to include those payments that ASCAP may make to those individual EC authors that are members of ASCAP and thus receive their royalties directly from it, rather than through EC CMOs. Consequently, the figures provided may be somewhat too high in some respects and too low in others, but we have not attempted to factor in these aspects into our calculations, given that they compensate for each other and that any difference between the two revenues is not likely to be substantial, and that, at any rate, their impact on the overall calculation would be quite limited.

4.47 The **United States** provided us with an estimation of the amount that BMI distributed to EC CMOs in 1996. The United States did not provide any data for the years 1997 and 1998. The **European Communities** does not contest the figure suggested by the United States. The **Arbitrators** have taken this figure as their starting-point in calculating the revenue that EC right holders received from BMI. However, they have made two adjustments to it.

4.48 The **European Communities** argues that if data on BMI's distributions to EC right holders through the EC CMOs were to be used, BMI's distributions to EC right holders' US publisher affiliates should also be taken into account in a similar manner as in the case of ASCAP.

4.49 The **Arbitrators** agree with the European Communities on this point. Lacking any data concerning BMI's distributions to EC right holders' US publisher affiliates, we have made an assumption that the share between BMI's "direct" and "indirect" distributions would be the same as the share between ASCAP's corresponding categories of distributions. We have accordingly made the appropriate adjustment to the estimate on BMI's distribution to EC right holders provided by the United States.

4.50 For the reasons explained above<sup>97</sup>, in calculating EC right holders' revenue from ASCAP, we have used the average of such revenues for the period 1996-1998. Although we have data from BMI only for the year 1996, we are of the view that in order to be consistent we need also to base BMI figures on similar average from the period 1996-1998. To be able to do so, we have determined BMI's distributions to EC right holders in 1997 and 1998 on the basis of the 1996 estimate, assuming that BMI's distributions grew over that period at the same rate as those of ASCAP. Subsequently, we have calculated the three-year average of these BMI distributions in 1996-1998. For the purposes of our calculation, this figure represents the annual average amount of revenues that EC right holders received from BMI prior to the 1998 Amendment.

4.51 Accordingly, for the purposes of our further calculations, we estimate that BMI's distribution to EC right holders prior to the 1998 Amendment was approximately US\$ xxxxxxxx per year.

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<sup>96</sup> See *supra*, para. 3.56.

<sup>97</sup> See *supra*, para. 4.45.

4.52 Adding up our estimations on ASCAP's and BMI's distributions to EC right holders, we estimate that, prior to the 1998 Amendment, EC right holders received approximately US\$ xxxxxxxx per year.

### **3. Royalties from eating, drinking and retail establishments**

4.53 Having established the annual average of the total amount of royalties EC right holders received prior to the 1998 Amendment, the Arbitrators will now attempt to estimate what share of that revenue came from eating, drinking and retail establishments. We will do this by deducting in two steps the royalties that were received from other types of users.

4.54 First we will estimate what share of the total licensing revenue paid to EC right holders was attributable to the so-called general licensing category. This category includes various types of licensees such as drinking and eating establishments and retail establishments, but it excludes licensing revenue from radio and television broadcasting and concerts. From ASCAP's annual reports for 1996-1998 it can be calculated that an average of 18.45% of the total domestic receipts was attributable to the general licensing category during this period. We have not been provided data that would have allowed us to calculate the corresponding share of BMI's receipts. In the absence of relevant data, we considered it reasonable to apply the same percentage to BMI's receipts. Using this percentage, we calculate that, of the total amount of revenue EC right holders received per year prior to the 1998 Amendment, approximately US\$ xxxxxxxx per year were attributable to the general licensing category.

4.55 The general licensing category includes, in addition to eating, drinking and retail establishments, miscellaneous users of background music such as airlines, sports stadiums, motion picture theatres, amusement parks, conventions, telephone music services, colleges and universities, health clubs and background music services. Therefore, we will need to estimate what share of the general licensing revenue is attributable to eating, drinking and retail establishments as defined in Section 110(5)(B). The problem we face is that we have not obtained any specific data on this question. Given that the general licensing category embraces many types of licensed uses, the United States claims that "a more than reasonable estimate is that 50% is attributable to restaurants, bars and retail establishments". We note that the European Communities has not contested this percentage suggested by the United States. Nor has it provided an alternative estimate.

4.56 We consider the US estimate of the percentage to be reasonable in the light of the arguments of the parties. Therefore, we use it in our calculation. Accordingly, we estimate that the amount of revenue received by EC right holders prior to the 1998 Amendment that was attributable to eating, drinking and retail establishments was approximately US\$ xxxxxxxx per year.

### **4. Royalties attributable to the playing of radio and television music**

4.57 The next step is to determine what amount of the revenue collected from eating, drinking and retail establishments was attributable to playing radio and television music as defined in Section 110(5)(B). This requires us to deduct the amount of royalty payments that was attributable to the use of other sources of music that were not exempted under that Section. For this purpose, both parties use in their respective calculations a figure of xx% as representing the share of this revenue that is attributable to the use of radio and television music. This figure is based on data from the National Restaurant Association and the National Licensed Beverage Association.

4.58 In using this figure, the **European Communities** notes that it does not include establishments that play music only from the television, but is not asking the Arbitrators to consider this factor. The **United States** notes that it has used this, in its view, high number to account for the fact that it has been unable to factor television use into the picture.

4.59 The **Arbitrators** note that this figure of xx% is based on actual data and that both parties use it in their respective calculations. The Arbitrators, therefore, decided to use this percentage in their calculation. Accordingly, we calculate that the amount of royalties EC right holders received from eating, drinking and retail establishments prior to the 1998 Amendment that was attributable to radio and television music was approximately US\$ 1.55 million per year.

## 5. Royalties from establishments that meet the requirements of the statutory exemption

4.60 The Arbitrators have now established the annual average amount of royalties EC right holders received from eating, drinking and retail establishments prior to the 1998 Amendment that was attributable to radio and television music. Next, they need to determine what share of that amount was attributable to establishments that were newly exempted from copyright liability by the 1998 Amendment, i.e., first establishments that were below the size limits of Section 110(5)(B) and thus exempted, and second establishments that were above those size limits but still qualified for the exemption because they met the conditions that concerned the equipment used.<sup>98</sup>

4.61 As regards the first category of establishments, both the **European Communities** and the **United States** use in their calculations the estimate from a 1999 Dun & Bradstreet study according to which 70% of eating establishments, 73% of drinking establishments and 45% of retail establishments fell within the statutory size limits.<sup>99</sup> The United States has calculated that the weighted average of these numbers is 53,9%. The European Communities has not contested the way the United States has counted this weighted average.

4.62 As regards the second category, the **European Communities** estimates that of those establishments that are over the size limits of Section 110(5)(B), only 10% meet the equipment limitations and thus benefit from the exemption. The **United States** notes that, due to lack of data, it has not tried to quantify the number of larger establishments that would meet the equipment limitations. In its rebuttal, it claims that the EC estimate is excessive, but it does not provide an alternative estimate.

4.63 The **Arbitrators** are of the view that they should include the establishments in the second category in their calculation. The problem is that neither party has provided any evidence to support their views. We note that the United States argues that it can be expected that large stores would be especially unlikely to play radio given, *inter alia*, broadcasters' varied programming, and that when businesses of sizes above the statutory limits would use broadcast music it would seem unlikely that a total of six speakers for the entire establishment would be sufficient. However, it would appear to us that the use of specialized music channels does allow businesses to control the atmosphere of a store, and that six speakers might well suffice for an establishment just over the size limit. At any rate, having regard to the arguments of the parties and the information before us, we are of the view that the EC estimate of 10% is already on the low side.

4.64 Using the weighted average of establishments below the statutory size limits provided by the United States, we calculate that an estimated 46.1% of eating, drinking and retail establishments are above the statutory size limits. In our view, the EC estimate according to which 10% of them meet the statutory limits concerning equipment is reasonable. Therefore, we will use this estimate in our calculation. Accordingly, for the purposes of our calculation, we assume that an additional 4.6% of establishments benefit from the exemption under Section 110(5)(B).

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<sup>98</sup> For details on the size limits of establishments and conditions relating to equipment, see the Panel Report on *US – Section 110(5) Copyright Act*, *supra*, paras. 2.10-2.14.

<sup>99</sup> See the Panel Report on *US – Section 110(5) Copyright Act*, *supra*, para. 2.12.

4.65 As a result, we estimate that 58.5% of eating, drinking and retail establishments are within the scope of Section 110(5)(B), either by falling within the statutory size limits (53.9%) or, in case their size exceeds those limits, by complying with the statutory equipment limitations (4.6%), and thus benefit from the exemption contained in that Section.

4.66 We note that, at the corresponding point in its calculation, also the United States has deducted from the remaining EC right holders' royalties the percentage that represents the share of establishments that fall within the statutory size limits, namely 53.9% (but not the 4.6% share that represents the share of larger establishments that comply with the statutory equipment limitations). It appears that this methodology of making the 53.9% deduction is not entirely accurate in two respects, although neither of these inaccuracies would appear to have a significant impact on the result of the calculation.

4.67 First, applying this methodology may not be entirely accurate as the exempted smaller establishments were likely to pay lower fees than the larger establishments that were not exempted. However, we have not attempted to factor this aspect into our calculation, given that we have not been provided any data or estimates that would enable us to do so. We also note that when we add 4.6% of the larger establishments into our calculation, we do not factor in the possibility that they may pay higher than average licensing fees. Overall, we believe that these considerations would not have a major impact on our calculation.

4.68 Second, the figure of 53.9% refers to all those establishments that fell within the size limits of Section 110(5)(B). We note that some of the smallest of these establishments were already exempted prior to the 1998 Amendment under the original homestyle exemption and, thus, were not newly exempted by that Amendment. However, as noted above, we have considered it appropriate to exclude from our calculation any hypothetical revenue for the playing of nondramatic musical works from the establishments covered by the original homestyle exemption, given, *inter alia*, that such revenue would most probably not significantly influence our calculation.<sup>100</sup> Similarly, we are of the view that the fact that the figure of 53.9% includes some establishments that were prior to the 1998 Amendment already exempted under the original homestyle exemption, does not essentially change the outcome of our calculation. To the extent it would have any impact on the outcome, it would compensate for the fact that we did not include revenue from such establishments in our calculations in the first place. For these reasons, we have not attempted to factor these aspects into our calculation.

4.69 Accordingly, we estimate that, of those royalties that EC right holders received from eating, drinking and retail establishments prior to the 1998 Amendment for the use of radio and television music, 58.5% was attributable to establishments that were newly exempted from copyright liability by that Amendment. This means that of the US\$1.55 million per year that EC right holders received from eating, drinking and retail establishments prior to the 1998 Amendment for the use of radio and television music, approximately US\$0.91 million was attributable to establishments that were newly exempted by that Amendment.

## 6. Further adjustments

4.70 As mentioned above, the Arbitrators have taken as the starting-point for our calculations the historical data made available to us on the revenue received by EC right holders prior to the 1998 Amendment. We have attempted to estimate, using the data and estimations provided to us by the parties, the share of those revenues that was attributable to relevant uses of broadcast music by establishments that were newly exempted by that Amendment. However, in our view, these figures

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<sup>100</sup> See *supra*, paras. 4.12 and 4.13.

have to be adjusted to take into account the evolution of the market between the entry into force of the 1998 Amendment and the date of referral of the matter to the Arbitrators, namely 23 July 2001.<sup>101</sup>

4.71 We recall that our above calculation is based on an average figure calculated on the basis of ASCAP's and BMI's distributions to EC right holders in 1996-1998 (in case of BMI, we had access to data only from 1996, but we assumed an annual growth corresponding to that of ASCAP's distributions). The figure of US\$ 0.91 million represents an estimate of the hypothetical level of nullification or impairment in the year 1997, i.e., about one year before the entry into force of the 1998 Amendment. Therefore, in adjusting this figure to reflect the level of EC benefits nullified or impaired at the date of referral of the matter to the Arbitrators, we will need to make an adjustment starting from the end of the year 1997.

4.72 In our view, the most appropriate way to adjust the aforementioned figure is to take into account the growth of the US economy in the same period. For this purpose, we have used the annual rate of growth of the US gross domestic product in current dollars in the relevant period. During this period, the US GDP grew in current-dollar terms at the following rate: +5.6% in 1998; +5.5% in 1999; +6.5% in 2000.<sup>102</sup> For the first six months of the year 2001, we have used the growth rate of 1.7%, which we have approximated on the basis of quarterly annualized figures of growth rates in current dollars.

4.73 We have adjusted the above figure representing the hypothetical annual average of revenue that EC right holders lost as a result of Section 110(5)(B) at the level of 1997 with the annual growth rate of the US GDP. Accordingly, we calculate that the level of the EC benefits nullified or impaired as a result of Section 110(5)(B) is US\$1,1 million per year.

## V. AWARD OF THE ARBITRATOR

5.1 For the reasons set out above, the Arbitrators determine that the level of EC benefits which are being nullified or impaired as a result of the operation of Section 110(5)(B) amounts to €1,219,900 per year.<sup>103</sup>

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<sup>101</sup> See *supra*, Section IV.A.2.

<sup>102</sup> See United States Department of Commerce Bureau of Economic Analysis News Release, 28 September 2001, <http://www.bea.doc.gov/bea/newsrel/gdp201f.htm>.

<sup>103</sup> Exchange Cross Rates, US Dollar to the Euro (11 October 2001), *Financial Times*, 12 October 2001, p. 25.

**ANNEX I****TEXT OF THE LETTERS SENT TO ASCAP AND BMI  
REQUESTING INFORMATION**

Dear Ms. Preston/Dear Ms. Bergman,

On 23 July 2001, the European Communities (EC) and the United States mutually agreed pursuant to Article 25.2 of the Understanding on Rules and Procedures for the Settlement Governing the Settlement of Disputes to enter into arbitration to determine the level of nullification or impairment of benefits to the EC as a result of the incompatibility of Section 110(5)(B) of the US Copyright Act with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). On 13 August 2001, WTO Members were informed of the composition of the panel of arbitrators.

In order to assist the arbitrators in determining the level of nullification or impairment, I would be grateful if you could reply to the following questions:

1. Could you please provide the following data for each of the years 1997-2000:
  - (a) the total domestic licensing revenues (excluding licensing revenues from foreign societies);
  - (b) the total licensing revenues from the general licensing category;
  - (c) the total licensing revenues from eating and drinking establishments and other establishments as defined in Section 110(5) of the amended US Copyright Act;
  - (d) the deduction for administrative and collection costs made before the distribution of royalties to right holders;
  - (e) the total distribution to right holders (excluding the distribution of licensing revenues from foreign societies);
  - (f) the total distribution to the EC collecting societies;
  - (g) any other data, if available, that would indicate the amount of distribution to EC right holders directly through your society (rather than through the EC collecting societies), in particular US publisher affiliates for performances of EC works.
2. With reference to question 1(c) above, to the extent you have any information available, could you please indicate the breakdown of the licensing revenue from eating and drinking establishments and other establishments as defined in Section 110(5) of the amended US Copyright Act that fall:
  - (i) under the size limits of Section 110(5)(A);
  - (ii) between the size limits of Section 110(5)(A) and (B); and
  - (iii) establishments the size of which is beyond the limits of Section 110(5)(B).
3. Could you please provide any available information on the likely number of establishments that would meet the requirements of Section 110(5)(B) which relay broadcast music.

4. To the extent feasible, please provide your estimation of the share of each category of establishment referred to in Section 110(5) that play broadcast music you are currently licensing.
5. Please provide the rates applicable to the various categories of establishments referred to in Section 110(5).

Needless to say, any information described as confidential in your reply will be treated as such. If you so request, the arbitrators will ensure that only the parties to this case will have access to this information. Moreover, the public version of the arbitrator's report will be edited so as to ensure that it does not contain any confidential data.

I should like to stress that, while there is no obligation for you to reply to the questions above or to submit any of the information requested, your full cooperation would be greatly appreciated.

Since the arbitrators' proceedings are subject to very short deadlines, I would appreciate it very much if you could provide us with any reply by Friday, 14 September 2001.

Yours faithfully,

Ian F. Sheppard  
Chairman  
Arbitration Panel on *United States – Section 110(5)*  
*of the US Copyright Act*

**ANNEX II**  
**SPREADSHEET OF CALCULATIONS**  
**OMITTED AS CONFIDENTIAL**

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