

Development of the audiovisual markets and creation of original contents

Report prepared for Mediaset[§]

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Executive summary

The evolution of digital technologies and broadband penetration have given rise to a significant change in the Italian audiovisual markets, through the development of new methods of usage:

- Following the convergence process that took place in the last 10 years, all audiovisual operators are now part of a single market. Services offered by broadcasters now compete side by side with other audiovisual services that are accessible via net-based devices, such as tablets and smartphones;
- The offer of audiovisual services is characterised by a significant heterogeneity: operators with different business models like broadcasters and Over The Top (OTT) co-exist in the same market

The system of audiovisual markets emerging from this transformation shows considerable imbalances. The deep regulatory and fiscal unbalances on the one hand and the lack of an effective copyright enforcement on the other, have a negative impact on the investments in the creation of content:

- Compared to the regulatory regime applied to European content providers, the regulatory regime applicable to OTTs is much lighter:
 - the OTTs are not burdened with strict rules concerning editorial responsibility, obligations for allocating investments, advertising limits, pluralism and protection of minors; furthermore, OTTs are often able to choose the fiscal regime applicable to them amongst the various jurisdictions in which they operate.
- Broadcasters cannot set their investments, commercial strategies or scheduling with the only aim of profit maximisation because they are limited by legislation (unlike the OTTs). Moreover, the differences in fiscal regimes lead to significant differences in the levels of costs.
- Digital piracy by means of peer-to-peer and video-sharing channels is pervasive in Italy: the most recent studies for Italy estimate the annual number of acts of piracy as approximately 384 million per year; and a percentage of interviewees who had committed an act of piracy at least once, in any form, was equal to 37%.
- The availability of content over unauthorised channels reduces the end users' willingness to pay, thus creating a price effect that causes a damage on top of the volume effects.

In conclusion, the asymmetry in the regulations on the one hand and an ineffective copyright enforcement system on the other have favoured the growth of the operators that do not invest in the production of original content:

- Digital platforms and, in particular, the distributors of unauthorised audiovisual contents (Youtube, Dailymotion, Vimeo), earn an increasing percentage in advertising revenues but do invest only 10% of their revenues in the production of original content (vs. 45-65% for broadcasters).

- European broadcasters operate as integrated and multi-platform media companies, and play a key role in the defence of cultural diversity in Europe, which is a fundamental priority of the European Union, as specified in article 3 of the EU Treaty.
- The loss of income for traditional industries translated already into decreased investments in original content and, in the long term, impoverishment of the audiovisual system - to the detriment, ultimately, of the quantity, quality and diversity of available content for end users.

1. Introduction

The creation of original content is a fundamental element of audiovisual markets. Content is an essential input for all methods of transmission. Its quality, quantity and variety are crucial factors for the welfare of viewers - as well as constituting a cultural asset that goes beyond its economic value.

The creation of content is an activity characterised by high fixed costs, necessary for development and production, and negligible or null marginal costs. Such cost structure and the intangibility of the asset raises a problem of appropriability of the return on the investments made by the authors and the other subjects operating in the value-chain.

The copyright instrument meets this requirement. It enables firms to collect, over time, a return from their work, allowing the various inputs providers to be remunerated. This preserves the right incentives to invest in audiovisual content and feeds the creation of the same in the medium and in the long term.

The audiovisual ecosystem has been characterised by considerable changes in recent decades, largely made possible by technological developments. New consumer habits have emerged which have brought closer supply and demand, giving life to on-demand services. Usage of traditional television has been progressively complemented by net-based devices – smartphones, tablets, smart-TV, that are used more and more often for enjoying audiovisual content.

A significant number of new operators, so-called Over-The-Top or OTT, entered the market, offering audiovisual services that use the Internet infrastructure, without having their own distribution/delivery network. However these operators are subject to a regulatory framework that is different from the set of rule to which broadcasters are subjected.

The objective of this study is to retrace the changes which have recently characterised the national audiovisual system and assess the consequences of such developments on the mechanism for creating original content. In particular:

- section 2 describes the changes which have taken place in audiovisual markets in recent years;
- section 3 compares the regulatory regimes to which broadcasters and other operators are subjected;
- section 4 describes the phenomenon of unauthorised use of content protected by copyright and analyses the impact thereof on firms;
- section 5 describes the imbalance which has been created in the market and its consequences on the production of original content;
- section 6 concludes.

2. The audiovisual system: the emergence of new models

The last decade has been characterised by a rapid convergence of traditional and digital media towards one single market: it is now possible to access the same audiovisual content by means of multiple instruments ranging from traditional TV to all the net-based devices.

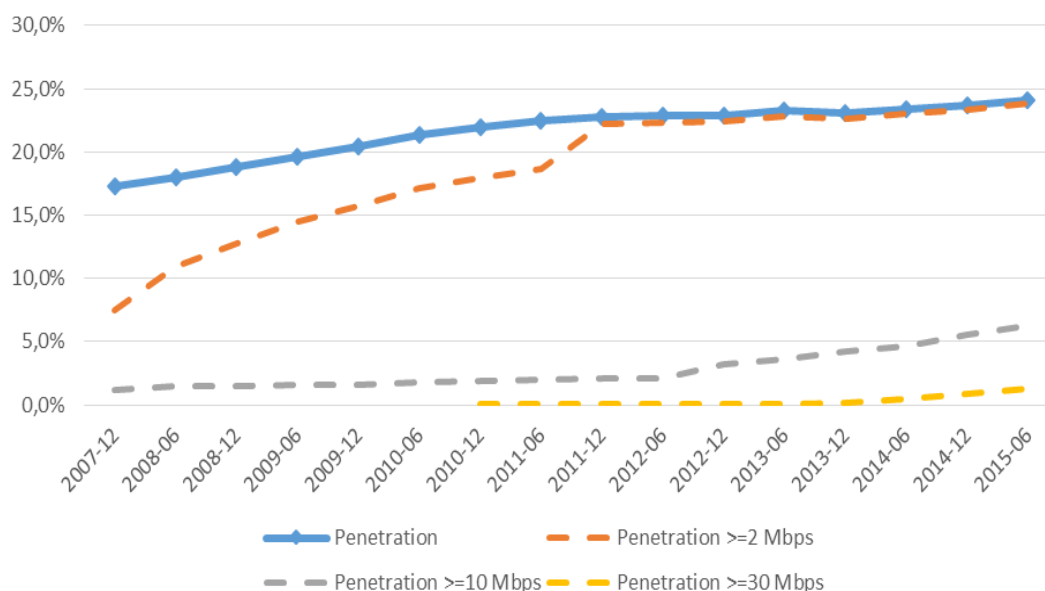
The digital revolution has, on the one hand, facilitated the entry of new operators, offering audiovisual content on digital platforms and, on the other hand, it has brought about a rapid development in traditional instruments (consider Internet enabled TV and smart TV). Broadcasters compete with new methods for consuming audiovisual services and with the “OTT” operators.

This section describes the recent process of convergence of the media and provides an updated picture of the Italian audiovisual market. In particular, section **Error! Reference source not found.** explains the phenomenon of media convergence; section 2.2 describes the various operators and various business models operating in the Italian audiovisual market.

2.1. Media convergence

The deployment of broadband networks, both fixed and mobile, has altered the boundaries of the market for video services and content. The penetration of fixed broadband technologies in Italy reached 25% of the Italian population in the second six months of 2015; connection speed available to end users also displays an upwards trend (Figure 2.1).

Figure 2.1 – Fixed broadband penetration by speed



Source: Lear based on European Commission 2015a

Mobile connection technologies show the same trend: in 2015, 98% of the Italian population was covered by 3G technologies; 90% by 4G¹ technologies.

In the meantime, usage of net-based devices – specifically smartphones, tablets and smart and connected TV – for the consumption of audiovisual services has also increased. In 2015, the percentage of people owning a connected TV was around 41%, a rate of penetration among the highest in the countries considered (see Table 2.1). These include not only smart TVs equipped with both web browsers and applications, but also all the other devices enabling access to the Internet by means of traditional televisions (for example consoles for latest generation videogames, Blu-ray players and streaming boxes such as Google Chromecast or Apple TV).

Table 2.1 – Possession of connected TVs and tablets and use of smartphones per country (% of respondents)

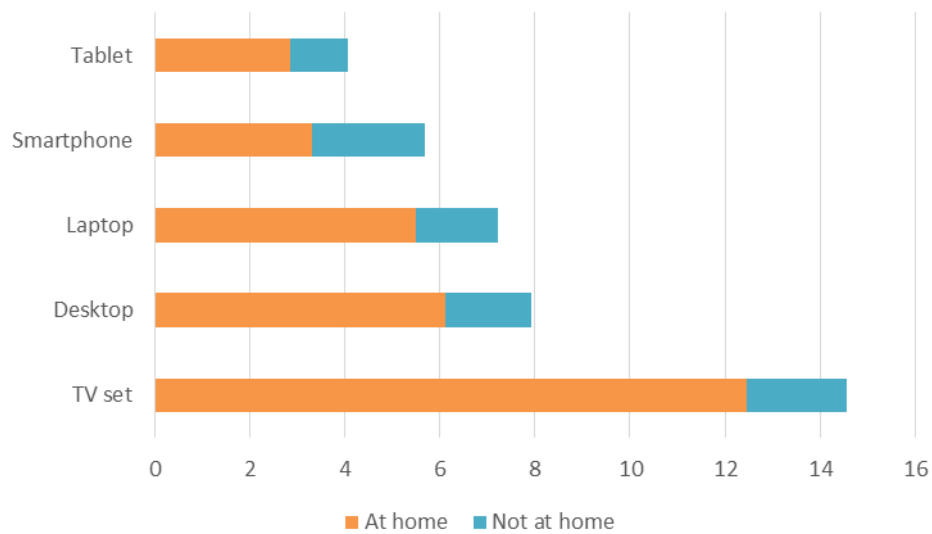
Country	Connected TV	Tablet	Smartphone
Germany	36	43	70
United Kingdom	42	54	67
Italy	41	63	79
France	30	48	66
Spain	45	65	83
Sweden	40	50	74
United States	32	42	57
Japan	17	31	77
Australia	39	52	69

Source: Ofcom 2015

Mobile devices such as laptops, smartphones and tablets now constitute relevant means to view audiovisual content. Based on Ericson data for Italy, shown in Figure 2.2, in 2014 the number of hours spent on these devices on a weekly basis was almost eight hours for laptops, four for tablets and six for smartphones (an increase of 22% compared to 2012). A significant part of these hours of viewing activity does not take place at home.

¹ Data from the European Commission, Digital Agenda Scoreboard.

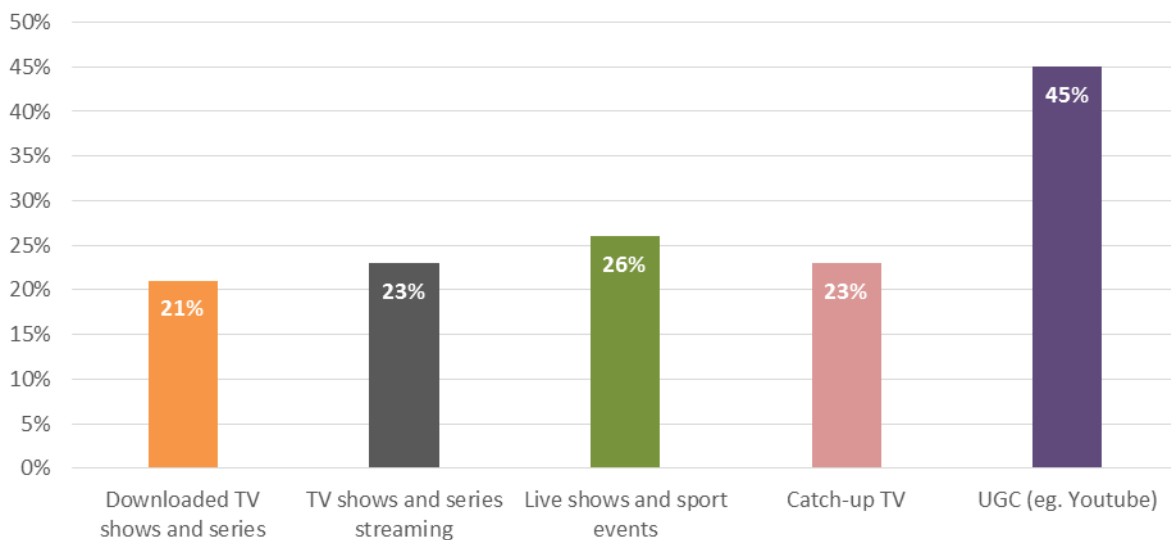
Figure 2.2 – Hours of use of audiovisual content per device per week



Source: Lear processing on Ericsson data, 2014

Figure 2.3 shows statistics related to smartphones only, and in particular to the types of content accessed by means of this device: 21% to 26% of smartphone owners used them to watch content which can be traditionally considered as television related, such as TV series, films and sporting events; 45% use them for accessing video-sharing platforms such as Youtube.

Figure 2.3 – Usage of smartphones to view audiovisual content, by type of content

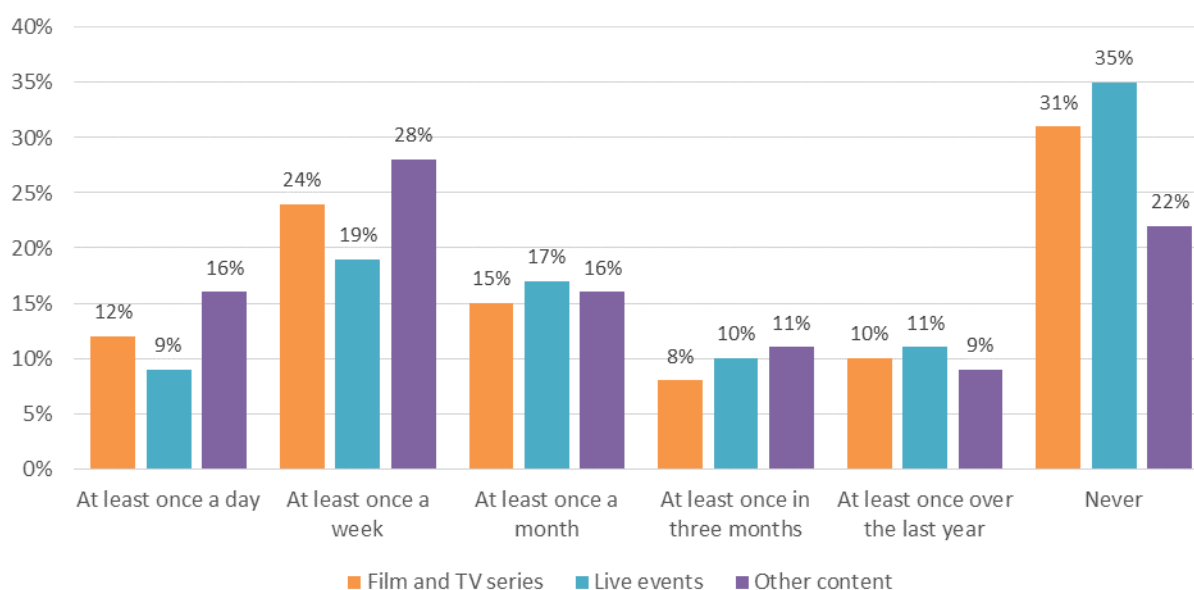


Source: Ericsson, 2014

Data from a study by the European Commission helps understand the scale of this phenomenon. As shown in Figure 2.4, in 2015 69%, 65% and 78% of the Italian population used Internet at least once to watch films and TV series, live events and other video content respectively; 36% of the population accesses films and TV series via the Internet on at least a weekly basis. According to the Ericsson

report, in 2014 the percentage of the Italian population using online streaming for entertainment surpassed that using linear services (80% versus 79%).

Figure 2.4 – Frequency of online access to audiovisual content



Source: Lear based on data from European Commission 2015b

Recent technological innovations contribute to placing linear broadcasters in direct competition not only with pay-TV broadcasters but also with OTTs, i.e. operators that, unlike traditional broadcasters, do not rely on their own infrastructure to supply content but rather use the Internet to this purpose. The new services have also brought supply and demand closer together, for example through the introduction of on-demand services.²

In response to this new trend, broadcasters have extended their offer on terrestrial, satellite and Internet platforms. Starting from 2005 and 2009 respectively, RAI and Mediaset offer a generalist and thematic video library in which they offer content already aired (replay TV).

In recent years, pay-TV platforms have also proposed offers that include “cloud live” TV through which end users can enjoy content and programmes through an Internet connection on smartphones or tablets. Mediaset created its own OTT, Infinity, where it makes premium content available. Sky too should launch new on-demand services in the near future, also aimed at those who have not already subscribed to the satellite platform. Sky lastly expanded its services adding three free-to-air channels: Sky TG24, MTV8 and Cielo.

The penetration of digital platforms and the changes in consumer habits have had a relevant impact on the film industry as well. Revenues from cinemas suffered a fall equal to 4.7% in the period 2012-2014. Already in 2010 the main source of revenue for film producers was represented by the license of exploitation rights to other firms. According to an ANICA 2011 study, three quarters of the revenues from the film industry in 2010 are accounted for by the sale of rights of use on productions to television broadcasters, home video operators and OTT operators.

² The percentage of Italian population subscribed to any one of the forms of Video on demand reached 19.1% in Italy in 2014 (Data from Digital Agenda Scoreboard).

2.2. Audiovisual business models

The increase in operators active in the audiovisual sector is accompanied by an increasing heterogeneity in terms of their business models and in the investment they make in the production of original content.

The business models of television companies are mainly Free-to-air (FTA) and pay-TV. Both public service television and commercial television belong to the FTA model. Public service television (e.g. RAI) collects part of the revenues from the TV licence and part from advertising; commercial television, (e.g. Mediaset, La7) instead, has advertising as its main (or exclusive) source of revenue.³

The pay model is a business model whereby access to content is conditional upon the payment of a fee. This fee can be charged for each distinct view (pay-per-view) or on a subscription basis to obtain access to a bundle of channels.

OTT operators mainly adopt a video on demand (“VOD”) business model. Indeed, unlike TV operators, they exclusively supply on-demand services. Public TV and commercial TV (excluding the exceptions cloud live and pay-per-view) typically offer linear services, which is based on a schedule.

There are mainly three business models for OTTs: (i) TVOD (Transactional VOD) – this is the model for iTunes by Apple, Chilli TV and Google Play, whereby each individual content is purchased⁴; (ii) SVOD (Subscription VOD) – this is the model for Netflix, Infinity, Tim Vision, where access to the entire catalogue is granted upon payment of a fixed fee; (iii) AVOD (Advertising VOD) – this is the model for Youtube and Dailymotion, whereby access is free and advertising is the main source of revenue⁵. The operators belonging to the various categories are shown in Figure 2.5.

Figure 2.5 – VOD business models



³ Based on the limitations imposed on the viewer, free TV is separated, in turn, into: i) free-to-air, this means television transmitted in unencrypted form and therefore available to anyone having a receiving device; ii) free-to-view, which identifies all transmissions having an encrypted signal, access to which is only permitted under certain conditions, as in the case of channels offered free to those already owning a paid subscription (e.g. MTV for Sky subscribers).

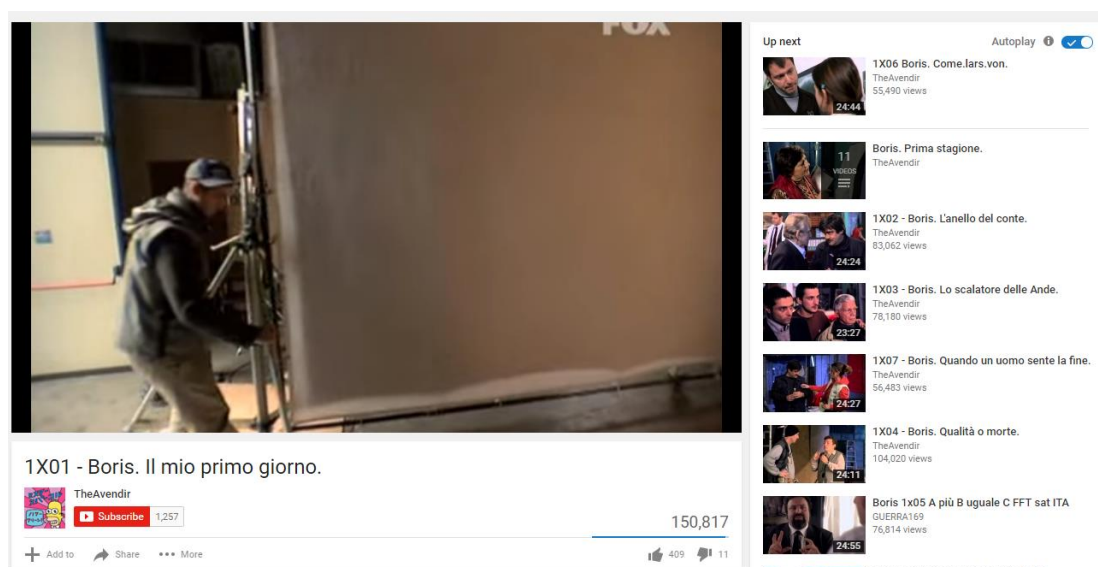
⁴ The same model as pay-per-view.

⁵ This model is also adopted by Mediaset and RAI portals for replaying programmes that have already been aired.

Source: Lear

AVOD operators such as Youtube are video-sharing platforms, the content of which is uploaded by users and automatically made available to the public. Even if YouTube does not check the content uploaded by users, it indexes it so that it can be easily searched by means of the internal search engine as well as external search engines and gives suggestions to users concerning other content of interest to them according to their preferences (based on their viewing history) and the relationship to the video they are looking at. Figure 2.6 illustrates how the mechanism works: as a user watches an episode of a popular TV series, Youtube displays links to the following episodes.

Figure 2.6 – Mechanism of related videos



Source: Lear

In the case of the film industry, original productions or exclusives acquired for national territory are distributed through of a series of “windows”, starting from cinema theatres and passing through the sale of content to TV, Home Video and OTT operators.

TV, cinema and OTT operators generate all their own turnover, albeit through different mechanisms, by making cultural content available to the public. Nonetheless, not all of them make the same investments in the creation of content. According to a recent study by Ernst & Young (2016), broadcasters (on terrestrial or satellite platforms) invest 45% to 65% of the turnover in original content; OTT operators, instead, allocate 10% to 70% of their turnover in expenditure for content.

OTT operators are, however, characterised by a relevant heterogeneity in terms of expenditure for audiovisual content: indeed it is possible to distinguish between authorised and unauthorised distributors (sometimes defined as “aggregators” or “technical intermediaries”). Netflix, Chilli TV and Infinity are an example of authorised distributors of original content, or OTT TVs. This generally concerns SVOD operators, whose main source of revenue is represented by subscriptions. It is estimated that these operators allocated 40% to 70% of their revenues in the acquisition of content. The Berger (2015) study observes that in 2014, Netflix allocated about 73% of its gross annual revenues per user to expenditure for content.

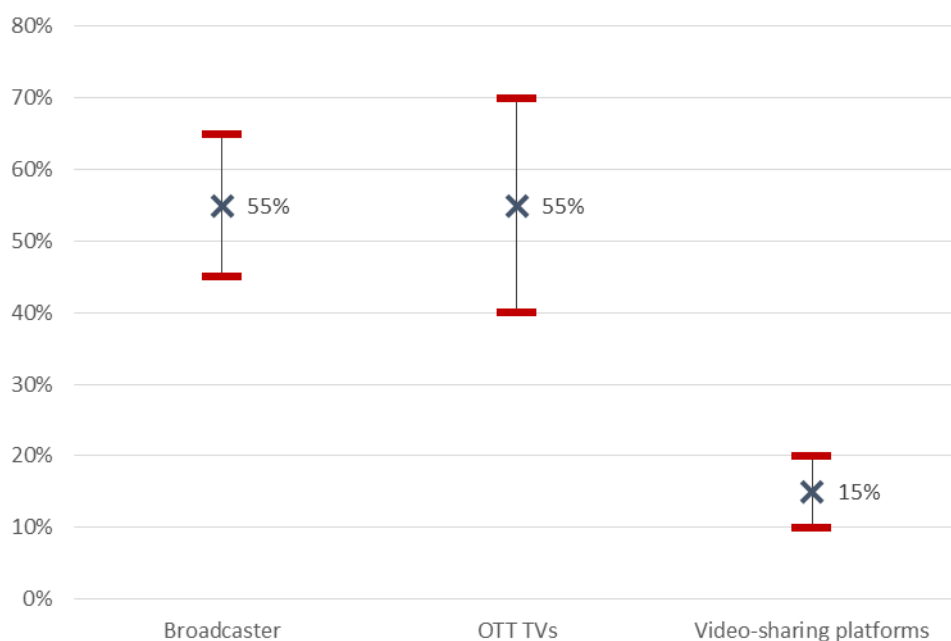
Platforms such as Youtube, Dailymotion and Vimeo are, instead, mere distributors of digital content. Since on these platforms the end users themselves upload videos, it is common for them to end up hosting copyrighted content without an authorisation or license from the right holder. They are

AVOD operators that obtain their revenues from advertising. Differently from authorised distributors, these platforms do not allocate a relevant portion of their turnover to the remuneration of copyrights. According to the Ernst & Young study (2016), platforms such as Youtube only allocate a modest percentage of their turnover to expenditure for original content (between 10% and 20%).

The Berger study (2015) reveals that approximately 66% of Youtube's turnover in the Italian market in 2015 derives from the distribution of cultural content (Cinema, TV, music). This concerns about 43 million in revenues collected entirely by Youtube by exploiting copyrighted material. Of this revenue, only a tiny part has been invested in expenditures for original content. This discrepancy generates a value gap, or a difference between the value gained from digital content distributors and the value recognised to copyright holders.

Figure 2.7 summarises these differences between the various types of operators. OTT TVs, video-sharing platforms and broadcasters all base their business on the distribution of cultural content, but contribute to their creation to a widely different extent.

Figure 2.7 – Expenditure for content as a percentage of turnover



Source: Ernst & Young, 2016

This discrepancy contributes to the impoverishment of the audiovisual industry: unauthorised distribution, examined further in section 4, denies, *de facto*, producers of original cultural content of a part of the returns in their investments, interrupting the mechanism for the creation of value which starts from the production of content and moves on to its circulation by means of various channels of distribution.

3. The regulatory asymmetry of the audiovisual markets








Given the process of convergence described in the previous section, broadcasters and OTTs end up competing in the same market: the market for audiovisual content for entertainment. Notwithstanding this relation of direct competition, there is a strong asymmetry in the norms and regulations that apply to these two categories of operator.

Television broadcasters are identified in European Directive 2010/13/EU as a “linear audiovisual media service” and are thereby subject to such regulation. In Italy the directive was transposed by Legislative Decree 15 March 2010, no. 44 which amended the previous “Single act for audiovisual and radiophonic media services” (Legislative Decree 31 July 2005, no. 177). Article 4.1 of the Decree provides the definition of “audiovisual media service”; it excludes “services rendered in the exercise of mainly non economic activities and which are not in competition with television broadcasting, such as private Internet sites and services consisting in the supply or distribution of audiovisual content generated by private users for the purposes of sharing or exchanging within communities of interest”.

The normative in force therefore establishes that the OTTs are not subjected to the rules laid down for suppliers of audiovisual services and generates considerable competitive imbalance in the market for audiovisual content. Although offering the same content, broadcasters and OTT operators are not subjected to the same responsibilities. This gives rise to a competitive disadvantage precisely to operators feeding the creation of creative content, the broadcasters. Moreover it weakens the protection guaranteed to end users. The ubiquity of the digital offer is such to allow users to easily change from traditional and linear services to digital on demand services. Moving from one service to another implies, though, a change in the conditions of protection: unauthorised distributors, for example, do not guarantee media pluralism, commercial transparency or the protection of minors.

Figure 3.1 provides a summary of the various limitations burdening traditional operators and OTTs.

Figure 3.1 – Legislative limits related to the various business models

Broadcasters		Requirements	OTTs
 MEDIASET	✓	Editorial responsibility	✗ 
 Rai	✓	Investment obligations	✗
 sky	✓	Fiscal regulation	✗ 
 LA7	✓	Ads threshold	✗ 
	✓	Media pluralism	✗
	✓	Child protection	✗

Source: Lear

Below we discuss the conditions of regulatory asymmetry between broadcasters and OTT operators in the audiovisual ecosystem, together with a description of the competitive consequences of such asymmetry.

- *The “editorial responsibility”:*

The SMAV Directive (2010/13) defines editorial responsibility as a key criterion for identifying the operators to which the Directive apply. Editorial responsibility is defined as “the exercise of effective control both on the selection of programmes and their organisation within a chronological schedule in the case of television broadcasts, or in a catalogue, in the case of on-demand audiovisual media services.”⁶ Such definition thereby excludes operators such as Youtube, the main role of which is to aggregate and make content uploaded by users available, even if the indexing activity carried out by Youtube could fall within the context of editorial activities. The normative in force has therefore created a decisive competitive imbalance in the market for audiovisual services, feeding the coexistence of operators subject to the pervasive obligations of the SMAV directive and operators which, albeit offering the same type of content (and in some case the same content), are free from all limitations.

- *Investment obligations:*

Broadcasters (“publishers”) such as Mediaset, are obliged to invest 10% of their turnover into the independent production of original content. This obligation also identifies, at least to some extent, which works the operators are bound to invest in (e.g. cinematographic works of original Italian expression).

- *Fiscal regulation:*

Thanks to mechanisms for optimising fiscal pressure, on activities realised in Italy some OTT operators are able to obtain the application of a foreign tax regime, which is characterised by lower tax rates,. This confers a relevant cost advantage to them, that may lead to the adoption of aggressive commercial policies than cannot be matched by national operators.

- *Limits to advertising:*

Broadcasters face limit in the amount of advertising they can display. The public broadcaster cannot transmit advertising messages for a time exceeding 4% of the weekly schedule of programmes; commercial broadcasters are subject to a 15+5 %daily limit (15% applying to spot advertising and the remaining part for other forms of advertising). Furthermore, hourly limits exist: public broadcasters and private broadcasters cannot exceed respectively 12% and 18% of advertising content in one single hour. This limitation directly affects the offer of advertising spaces by television broadcasters, creating a competitive disadvantage vis-à-vis OTT operators which, not being subjected to such limitations, can supply a potentially infinite quantity of advertising content.

- *Pluralism:*

Another limit to the commercial freedom of broadcasters in defining the scheduling derives from the legislation aiming at protecting political and cultural pluralism. Indeed, broadcasters must guarantee the daily transmission of information programmes which truthfully present facts and events, promoting a liberal formation of opinions by the public. Moreover, transmissions on political information must allow access to all political parties under conditions of impartiality. In other words, when defining their commercial offer in the context of information, traditional broadcasters cannot exclusively take account of the public’s preferences and make choices aimed at maximising their

⁶ Audiovisual Media Services Directive (2010/13), Art. 1, letter c.

profit. OTTs are not subjected to such limitations, although in some cases they also offer news and similar content.

- *Protection of minors:*

Article 9 of Legislative Decree 44 of 15 March 2010 and the Code of self-regulation for media and minors set rules that aim at protecting minors . The main purpose of the limits imposed by the decree is to impede the transmission of content that could be harmful to the physical, psychic or moral development of minors in well-defined time bands. The latter vary depending on the age for which the content is not recommended and in any case, also outside of such time bands, broadcasters are obliged to report programmes not suitable for minors. This also constitutes a limitation and a condition of asymmetry in broadcasters respect to OTTs and prevents broadcasters from freely defining their commercial offer from the viewpoint of maximising profit.

4. The enforcement of copyright

The logic underpinning the regulation of copyright is to guarantee that the copyright holder retains the proper incentives to devote time and other resources to the creation of original works.

In the case of the audiovisual industry, broadcasters invest a considerable share of their turnover in the production and acquisition of works. Whenever their right to an exclusive exploitation of the content is not fully protected, they have a lower incentive to invest. Therefore, the enforcement of copyright is a public need and an essential intervention to prevent possible market failures.

Changes in technology and consumer habits in recent years have brought about an increasingly greater difficulty in protecting copyright, giving rise to a proliferation of violations. Furthermore, the regulation in force is not fully effective in contrasting the phenomenon and has determined grey areas in which the legal responsibility of various actors is non clearly defined. Such aspects are explained further in section 4.1.

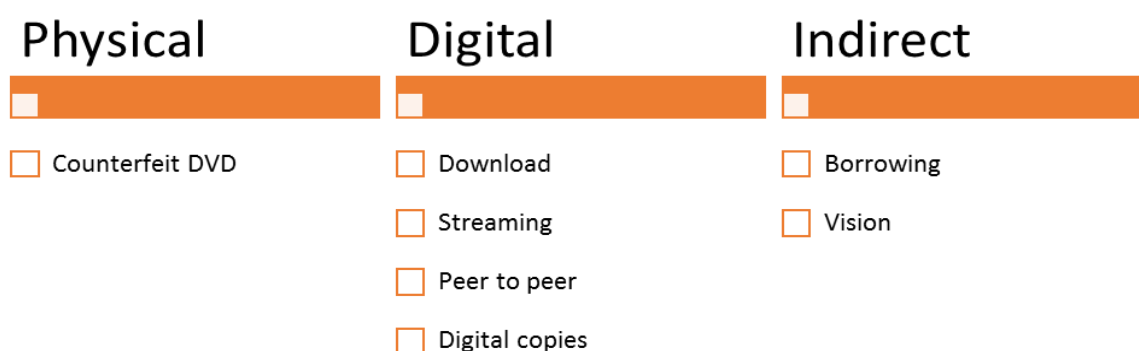
The economic exploitation of copyrighted material requires the existence of restrictions to the methods and channels of distribution. It is precisely such restrictions that confer value to audiovisual content. Unauthorised uses void the restrictions and strip the audiovisual content of part of its value. Section 4.2 discuss the mechanisms that lead to this problem and the likely impact on Mediaset revenues.

Piracy also affects Mediaset's costs. In the digital context, enforcement of copyright is actually left to the initiative of the right holder, who bears the costs. A brief description of the latter is given in section

4.1. Methods and numbers in piracy

The legal system confers an intellectual property right holder with exclusive economic exploitation of the protected content. The violation of such right constitutes a vast and complex phenomenon which can take place through various channels. Following the classification used by the Federation for the Protection of Audiovisual and Multimedia Content (FAPAV), classic piracy includes physical, digital and indirect piracy (Figure 4.1).

Figure 4.1 – “Classic” piracy and its types



Source: Lear processing

In the digital context, “classic” forms of piracy which are clearly illegal, such as peer-to-peer, are flanked by other unauthorised usages, such as video sharing, regarding which the attribution of legal

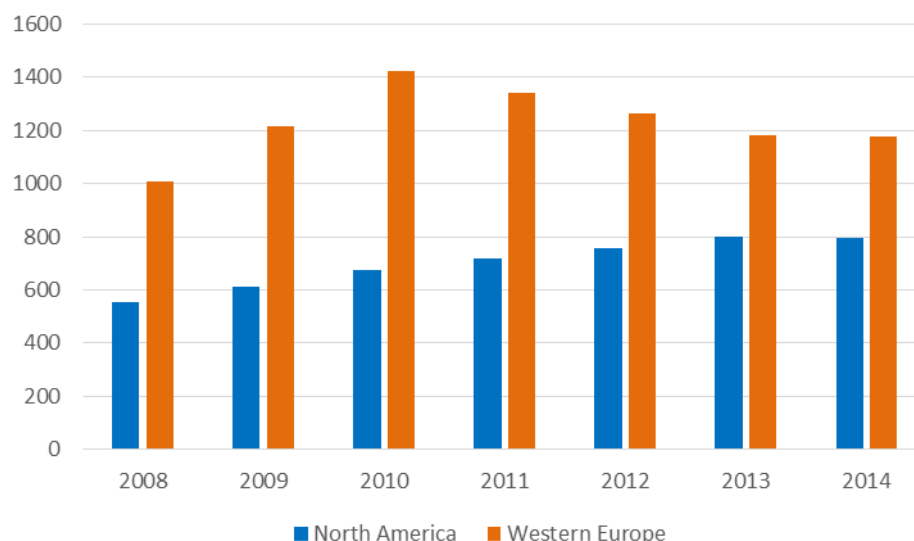
responsibility is more uncertain. These two practices are, though, united by the lack of authorisation granted by the right holder to use the copyrighted content. Hereinafter both cases are referred to as “unauthorised utilisation/use”.

The diffusion of Internet and progressive digitalisation of audiovisual content have contributed to a proliferation of unauthorised uses. Such progressive digitalisation in the consumption of audiovisual content has, in turn, altered the perception of unauthorised use: sharing and exchanging files (so-called file sharing) is substantially perceived as a legal action, given the immateriality of the downloaded, shared or exchanged content.

This trend can be found in recent data. An American study of 2014 carried out by the NPD group shows that, in 2011, the great majority of material present in The Pirate Bay (a famous file sharing site based on the BitTorrent sharing protocol) violated copyright rules: 78.1% concerned music and 92.9% television type content.

If file-sharing is measured in terms of petabytes (PBs) shared per month, one should note that it reached approximately 1,180 PBs in Western Europe in 2014, settling at levels much higher than those recorded in North America. In 2014, 20% of all European Internet traffic was formed of file-sharing and on an annual basis the content equivalent of 22 billion CDs was distributed without any authorisation.

Figure 4.2 – File-sharing as total petabytes shared per month



Lear processing on CISCO data (2015)

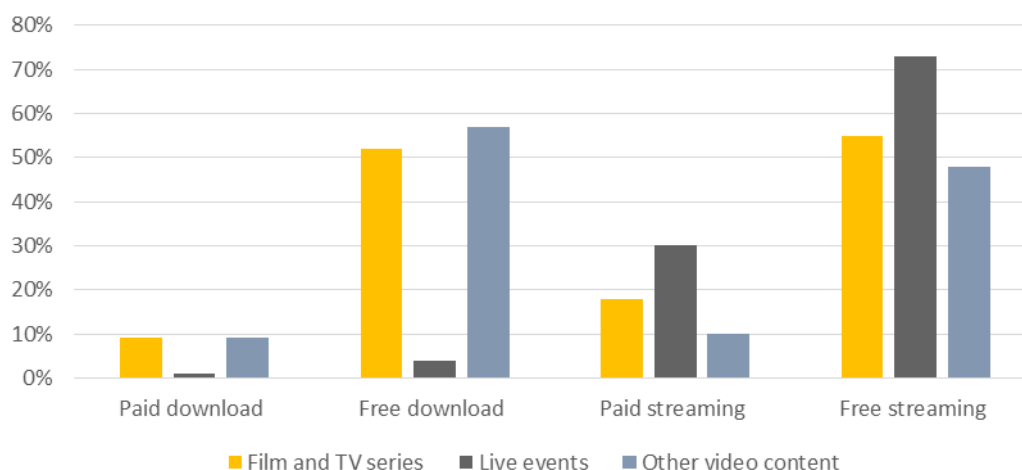
The unauthorised use of audiovisual content is also widespread on mobile networks and mobile devices, generally in streaming (given the lower storing capacity and memory available to mobile devices) as well as by means of apps. For example, the NetNames study of 2013 records a high number of apps - downloadable on Google Play Store – which guides consumers towards audiovisual content whose fruition is not authorised. Music Download Pro and Music Download Paradise have reached more than 10 million downloads. In the United Kingdom, TVCatchUp recorded more than 1 million downloads on Android and is often cited among the most widespread iOS apps in the country.

These data are widely confirmed on the national scene. According to the FAPAV/IPSOS 2011 report, audiovisual piracy in Italy is a particularly widespread phenomenon compared to other European countries, with a number of acts of piracy estimated in 2010 of approximately 384 million.⁷ The percentage of interviewees having committed an act of audiovisual piracy, in any form, at least once in 2010 was 37% – an increase of five percentage points compared to the previous survey, FAPAV/IPSOS 2009.⁸

With reference to cinematographic works, the FAPAV/IPSOS (2011) report estimates that in Italy in 2010 the total number of lost views exceeded 103 million, approximately 50 million of which attributable to piracy in the digital sector. The report calculates revenues comprehensively subtracted from the film industry due to unauthorised uses, of about 500 million Euros in 2010 alone.

Figure 4.3 shows the methods used to access audiovisual content online for the various categories of content in Italy. For films and TV series, free downloads and streaming represent by far the most used methods compared to pay alternatives. As films and TV series are generally distributed against a payment (a part from some TV series, which Mediaset makes available on its online services, at the same time of the TV broadcast), it can be reasonably considered that almost all of such views is unauthorised.

Figure 4.3 – Methods of using audiovisual content online



Source: European Commission, 2015

From a regulatory point of view, the growth in the phenomenon of unauthorised use in the digital sector led the Court of Justice of the European Union, in March 2014, to authorise Internet Service Providers (ISPs) to block Internet sites infringing copyright..⁹ This means that national courts of

⁷ Federation for the Protection of Audiovisual Content “Audiovisual piracy in Italy”, 2011.

⁸ Federation for the Protection of Audiovisual Content “Audiovisual piracy in Italy”, 2009.

⁹ Court ruling, 27 March 2014,

<http://curia.europa.eu/juris/document/document.jsf?text=&docid=149924&pageIndex=0&doclang=it&mode=req&dir=&occ=first&part=1&cid=289048> Court ruling, 27 March 2014,

<http://curia.europa.eu/juris/document/document.jsf?text=&docid=149924&pageIndex=0&doclang=it&mode=req&dir=&occ=first&part=1&cid=289048>

member countries can order an Internet service provider to block access by its subscribers to a website violating copyright.¹⁰

According to recent reports by the IFPI, to date 19 countries have ordered ISPs to block access to a total of more than 480 websites violating copyright. In Italy in 2013 24 sites hosting torrent and magnet link files, required for sharing and searching content by means of the BitTorrent protocol, were blocked. This action led to a decrease in the total number of downloads by BitTorrent by 25.6% in two years.

These enforcement activities are, though, only partially and temporarily effective. Websites blocked by authorities in a certain country can still be reached via VPNs, i.e. connecting to the website through another country where the block does not apply. Furthermore, the same site can bypass the block by changing domain and therefore URL. Lastly, the block of a site is often followed by the proliferation of other similar sites.

The boundary between what is deemed legal and what is illegal is not always clear. The same lack of clarity affects the identification of the subject that is legally liable for copyright violations. According to the E-Commerce Directive 2000/31/EC, distributors of audiovisual content, such as YouTube and Vimeo – if qualified as the suppliers of merely “automatic technical and passive” hosting services - could be considered as released from all legal responsibility in the case of violations of third party copyrights (safe harbour). Such directive at Article 12 establishes that “(...) where an information society service is provided that consists of the transmission in a communication network of information provided by a recipient of the service,(...) the service provider is not liable for the information transmitted”, under the condition that it is not aware of the fact that the activity is illegal. The directive then affirms that as soon as the provider becomes aware of the illegality of the stored content “it must act immediately in order to remove the information or disenable access thereto”.

In other words, the normative in force is inclined to be read in such a way as to induce one to believe that a distributor of digital content can publish unauthorised content and shall only be bound to remove it at a later date when informed of the illegal nature of the distribution of the content. The consequence of such interpretation would be that an unauthorised distributor has no incentive to check the origin of the content hosted by its platform and the cost of such check exclusively burdens the right holder - feeding further competitive imbalance.

In fact, , (), video sharing platforms offer a service that, even if can be formally qualified as “service of the information society”, is completely different from that of mere data storage. Only the latter can benefit of the limitation of liability pursuant to article 14 of Directive 2000/31/EC.¹¹

4.2. Description of loss of earnings by channel of monetisation

Unauthorised use determines progressive shifts in demand for audiovisual services: the availability of content through unauthorised channels lowers the end clients willingness to pay, as they have a free alternative for viewing the same or other content. This engenders both a price effect and a volume effect on legal services. More specifically, three effects can be distinguished:

¹⁰ Outside of the European Union, the same practice was authorised in Argentina, India, Indonesia, Malaysia, Mexico, South Korea, Turkey and Singapore, whilst a proposal of law is in progress in Australia.

¹¹ See Court of Milan ruling 7/6/2011 RTI c. Italia On Line, Court of Milan order 25/5/2013, Court of Rome ruling 27/4/2016 RTI c. Break Media; in criminal law Court of Milan, ruling 12 April 2010, Appeal Milan, ruling of 27/2/2013, no. 8611, Cassation, ruling 23/12/2009 no. 49437.

- *Direct volume effect*, when end users replace an authorised usage of audiovisual content with unauthorised usage of the same content.;
- *Indirect volume effect*, when end users replace an authorised usage of audiovisual content with unauthorised usage of different content. Such consumer choice is probably taken due to the absence of price barriers for unauthorised use;
- *Price effect*, deriving from end users' reduced willingness to pay for audiovisual content in general. The price effect derives directly from the lower value the end user attributes to the audiovisual content; and indirectly by the volume effects described above: lowering the price of authorised use can be the answer of the creator of the content to potential substitution with unauthorised use, aimed at limiting volume effects.

Furthermore, the structure of costs for the production/acquisition of original content ensures that revenue lost due to lack of use (volume effects) almost exactly corresponds to lost profit: the production/acquisition of original content has, in fact, high fixed costs whereas negligible or zero variable costs (i.e. costs stemming from an increase in the distributed/consumed volume).

In order to obtain an appropriate estimate of the financial damage caused by the circulation of unauthorised distribution, it would first of all be necessary to have information on the dimension of the phenomenon. Unfortunately available information is scarce and not many attempts have been made to measure the pervasive nature of unauthorised usage and illegal audiovisual use subtracted from broadcasters. The surveys by FAPAV/IPSOS in 2009 and 2011 represent the most recent attempts at reconstruction of this phenomenon for the Italian market.

The quantification of the financial impact of unauthorised usage is made difficult by the scarcity of information concerning the total number of violations (i.e. number of titles circulated without authorisation and number of times they were viewed). Moreover, the valorisation of such phenomenon would require the possibility to reconstruct (i) the number of views that would have been occurred absent the violations and (ii) the price at which protected content would have been sold - which often varies from the price actually charged due to the price effect described hereabove.

The following sections examine the mechanisms through which unauthorised uses damage the various channels of monetisation of broadcasters, with reference to each of the areas of activity of the Mediaset group: cinema (section 4.2.1), Free-to-air (4.2.2), Pay-TV and OTT (4.2.3).

4.2.1. Cinema

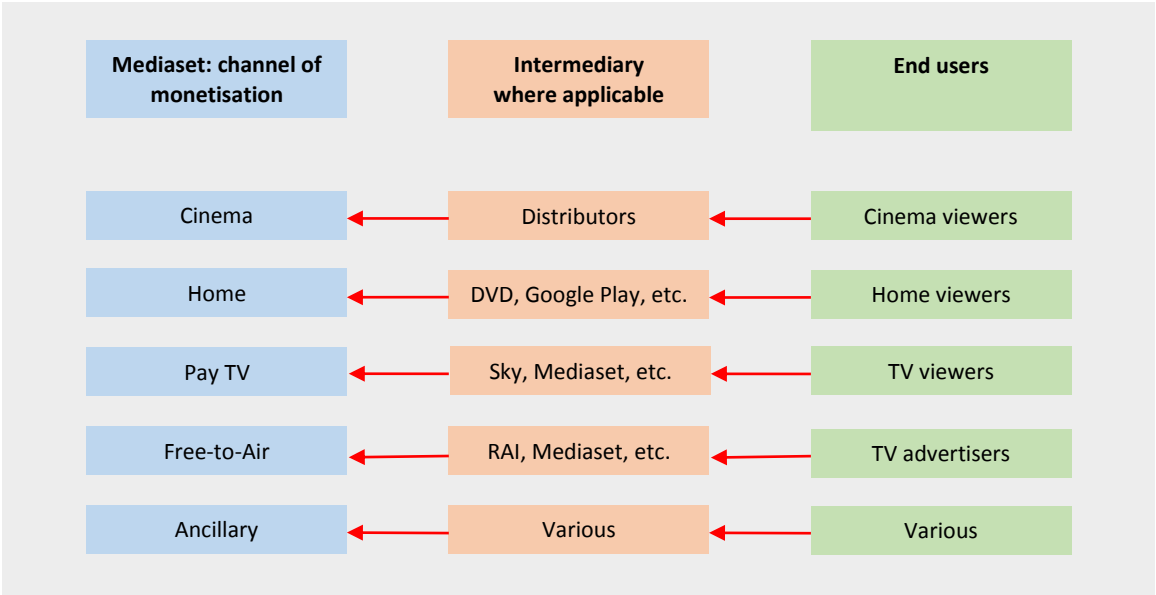
Italian and foreign films produced and acquired by the Mediaset group, in particular by the subsidiary Medusa Film S.p.A., are distributed throughout the national territory by means of various methods. Indeed, the supply chain of cinematographic product in Italy is formed of four main channels: cinema, home entertainment, pay TV (Mediaset Premium, Sky) and free television (Mediaset, Rai, La7, other Terrestrial Digital channels). Licenses to foreign operators should be added to the value chain of Italian films, as well as ancillary usage (hotels, licensing, merchandising, rights to remake and sequels, etc.).

The use of cinematographic content by these various channels of distribution is governed by a "windows" system.¹² Cinema theatres constitute the first output window. Around 15 weeks later, the film is launched in the home entertainment sector, both digital (legal streaming and download) and physical (DVD, BluRay), which corresponds to the second window. The third window, i.e. pay TV, opens in the 8-9 months after the theatre viewing. 24 months later the film enters the final window,

¹² Each window, and therefore every use, opens upon the sale of a licence to users by the producer; the producer therefore generates rights of financial use of the work which constitute its business revenue.

that is to say broadcasting in unencrypted television networks.¹³ The windows system is illustrated in Figure 4.4: the arrows represent the direction of monetary flows.

Figure 4.4 – Cinema: channels of monetisation



Source: Lear

As documented by the reports on monitoring activity carried out by Mediaset by an external company, online copyright violations in the cinema sector are numerous as early as the first days that the film comes out and sometimes even in the days beforehand. Therefore the entire supply chain and channels of monetisation undergo a knock-on effect due to the easy and rapid availability of cinematographic content over the Internet.

In particular, monitoring reports on “Perfect strangers” and “The Pills – always better than working”, show a relevant number of violations, i.e. unique URLs hosting content, in the month corresponding to the premiere, of 302 and 178 respectively. In both cases these violations come about mainly by means of streaming sites which form more than 65% of the total violations and via Torrent (more than 20%), whereas Facebook hosts a portion of violations ranging from 6 to 8%. Despite the fact that these last percentages may appear modest, the almost universal penetration of Facebook makes this content available to a huge number of users. Furthermore, the presence of unauthorised channels of use on Facebook varies according to the considered film: in the case of “Quo vado”, the violations found in the month of its release in theatres counted 153.

Evidence exists of how unauthorised use influences the choices of usage of the various categories of end users for cinematographic products. FAPAV and IPSOS (2011), in their survey, asked the following question “what would have you done if it was not possible to obtain an unofficial copy?”. The answers provide an estimate of the substitution rates for each method of authorised use as shown in Table 4.1.¹⁴ Considering the different legal channels of distribution/use, rental is the channel suffering the greatest losses, followed by the other forms of home entertainment and cinema.

¹³ The mentioned times are indicative, i.e. susceptible to change depending on the titles.

¹⁴ The total of all the alternatives equals 101%, presumably due to the rounding up applied by FAPAV and IPSOS (2011) on the values obtained by the random survey.

Table 4.1 – Rate of substitution per method of use

<i>Alternative to unauthorised use</i>	<i>Rate of replacement</i>
None	23%
Loan (relatives, friends ...)	9%
Viewing (from relatives, friends...)	7%
Cinema	14%
Rental Blu-ray and DVD	15%
Purchase Blu-ray and DVD	5%
TV on-demand / pay per view	3%
Official website (download /streaming)	2%
Satellite/digital terrestrial channels under subscription	3%
TV (channels not by payment)	20%
Total	101%

Source: Processing of FAPAV and IPSOS data, 2011.

The first three of the alternatives shown in Table 4.1 refer to activities not monetizable by Medusa: 23% would not have seen the content in question; 9% and 7% respectively would have borrowed the same title or would have watched it with friends or relatives. In total, the alternatives monetizable by Medusa in the counterfactual scenario are 62% of the unauthorised uses: these would have generated income for Medusa through the channels of monetisation described in Figure 4.4.

This change in the quantity of authorised uses is also accompanied by a change in price. Consider, for example, the Pay TV channel: when Medusa negotiates, with Sky or other pay operators, a certain price to license transmission rights in pay per view mode, this price depends, amongst others, on the price that Sky can charge to its clients/viewers. This latter price is lower if a large part of viewers are or have been able to view the title using illegal channels.

In the same way, the devaluation of the film “product” and the availability of the same content on illegal channels, even before its premiere, has an effect on the number of viewers willing to pay to see it in cinema theatres; and unauthorised streaming by means of OTT shall reduce prices and consumption of DVD rental/purchase and authorised streaming.

Box 1 provides an estimate of the damage suffered by Medusa in 2014 by effect of unauthorised distribution of protected content.

Box 1 – Summarised estimate of the impact of piracy on Medusa

In a counterfactual scenario in which content attributable to Medusa was not legally available, the legal use of such content would have increased. This usage would have generated revenues for Medusa which constitute the so-called loss of profit, based on negligible, if not zero, marginal costs. In order to calculate loss of profit, the following input is therefore necessary:

- (a) Total acts of piracy (intended as viewings) attributable to content owned by Medusa;
- (b) Estimate of lost legal usage;
- (c) Estimate of the financial value of lost usage.

The FAPAV/IPSOS 2011 survey contains an annual estimate of the number of acts of piracy in Italy on cinematographic material, equal to 384,201,000. This figure includes all types of piracy - from digital to so-called indirect. Presuming that the number of violations can be attributed to the various operators based on their market share and given a market share of Medusa was 7.8%¹⁵ in 2011, the number of relevant illegal uses for Medusa is estimated to be 30,149,389.

The FAPAV/IPSOS 2011 survey also provides elements for estimating the corresponding legal usage lost due to piracy: these were defined by apposite rates of substitution, or the percentage of legal uses per distribution channel which would have taken place, see Table 4.1.

Still to be identified are the unitary values of lost usage for Medusa by method of distribution. These were estimated using different sources:

- For “Blu-ray and DVD rental” and “Blu-ray and DVD purchase” reference was made to the prices given by FAPAV/IPSOS 2009 for “DVD catalogue rental” and “DVD catalogue purchase”, equal to €2.41 and €11.87 respectively. These values were then halved because only 50% of this unitary revenue is due to the producer/distributor;
- For the “Cinema” and “TV on-demand/pay per view” categories, Medusa data on revenues were used as well as the related usage pertaining to two Medusa titles. The average revenue obtained by Medusa in relation to agreements signed with Sky for distribution in PPV is equal to €1.32; the average revenue perceived by Medusa for theatre distribution is equal to €2.76.
- For the “TV (free channels)” channel, TERA (2010)¹⁶ estimates were used, based on the relationship between total advertising takings in Italy and an estimate of the average time passed in front of the TV by Italian viewers. In this case too, the value provided by TERA (2010), equal to €0.11, was halved in order to reflect the portion due to the producer/distributor.
- for “Satellite/terrestrial digital channels under subscription”, the financial value was identified by availing of the FAPAV/IPSOS 2011 estimate, calculating the ratio between the number of usage lost (4.1 million) and an estimate of the financial impact (8 million) for the related distribution channel, then halved to reflect the portion due to the producer/distributor.

Table 4.2 gives an estimate of loss of profit for Medusa attributable to piracy, divided into distribution channel.

Table 4.2 – Rate of replacement per method of use

<i>Alternative to piracy</i>	<i>Rate of replacement</i>	<i>Lost usage</i>	<i>Unit value of usage (€)</i>	<i>Lost profit (€)</i>
None	23%	6,934,359	0.00	0
Loan (relatives, friends ...)	9%	2,713,445	0.00	0
Viewing (from relatives, friends...)	7%	2,110,457	0.00	0
Cinema	14%	4,220,914	2.76	11,649,724
Rental Blu-ray and DVD	15%	4,522,408	1.21	5,472,114
Purchase Blu-ray and DVD	5%	1,507,469	5.94	8,954,369
TV on-demand / pay per view	3%	904,482	1.32	1,193,916

¹⁵ Data from the entertainment Foundation entity report “The Market and Industry of Cinema in Italy 2011”.

¹⁶ TERA Consultants, “Building a digital Economy: The Importance of Saving Jobs in the EU’s Creative Industries”, 2010

Official website (download /streaming)	2%	602,988	0.00	0
Satellite/digital terrestrial channels under subscription	3%	904,482	0.98	886,392
TV (free channels)	20%	6,029,878	0.06	361,793
Total	101%	30,149,389		28,518,307

Source: Lear processing on data from FAPAV 2011, TERA 2010, Cinetel, Medusa, FAPAV 2009.

Medusa's loss of profits is therefore established as equal to 28,518,307, i.e. 14% of its turnover.

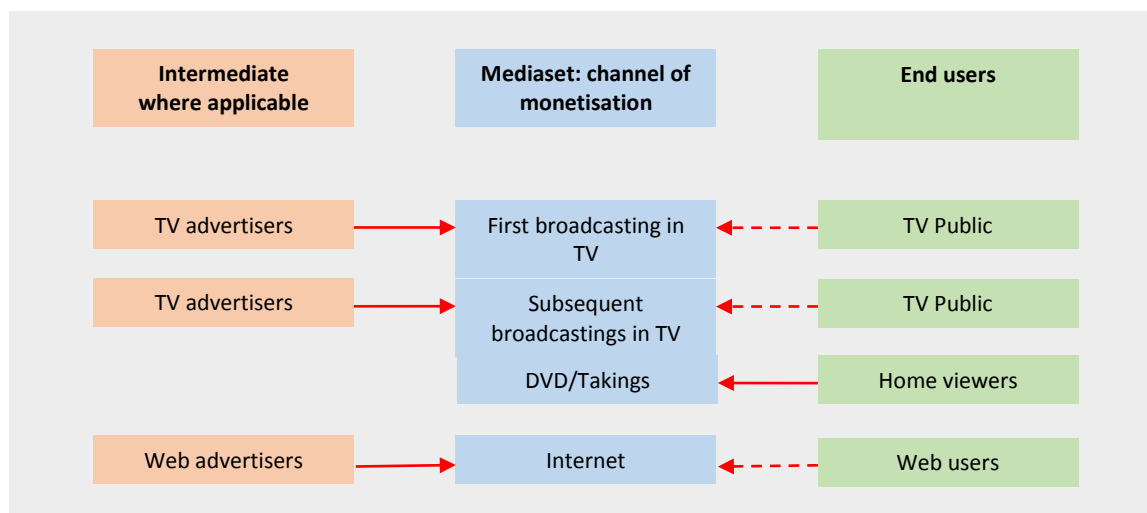
The provided estimate must be interpreted as indicative and prudential because it was carried out with reference to data from 2011 and the pervasiveness of piracy, therefore the number of lost usage, could have increased in later years. The method of estimation, moreover, does not permit valorisation of the price effect, or the lower price which can be extracted by Medusa in the various windows due to the deflationary effect of piracy.

4.2.2. Free to air

The Mediaset's subsidiary, RTI manages the channels Canale 5, Italia 1, Rete 4, as well as other channels freely available on DTT. RTI oversees the various networks arranging, directly or by means of its own subsidiaries, the creation and realisation of scheduling, production and acquisition of original programmes, the acquisition and management of libraries of rights and management of the distribution network of the television signal.

The channels of monetisation for the Free to air area of activity are represented in Figure 4.5: the dashed arrows represent indirect monetary flows. For the main channels of monetisation, Mediaset acts as a platform of intermediation between the viewing public and advertisers intending to reach that public - defined both in terms of volume and composition.

Figure 4.5 – TV free: channels of monetisation



Source: Lear

The audiovisual content acquired/produced by Mediaset is transmitted first of all as first run on one of the channels managed by Mediaset. Its monetisation comes about by means of advertisers. Based

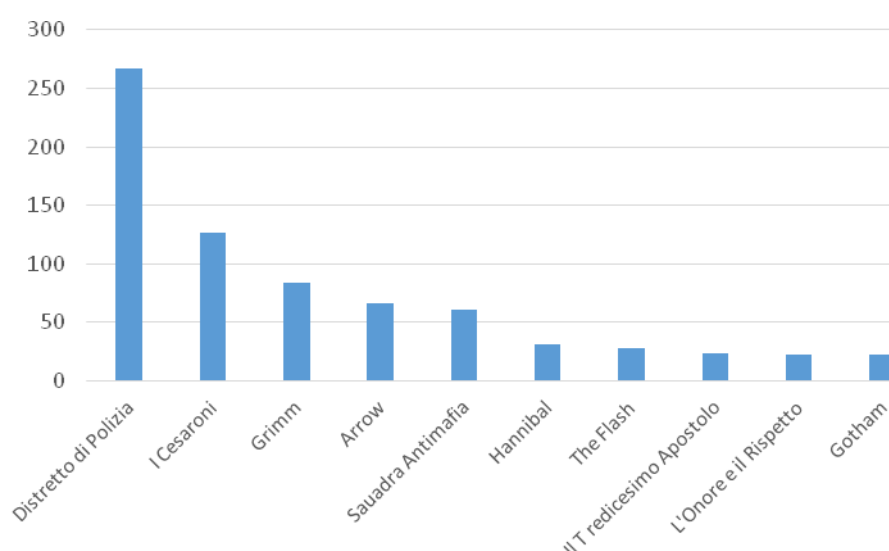
on the number and composition of the likely audience for this content, the latter buy advertising spaces for their own sales communications.

Unauthorised usage can affect both the number and composition of the television audience for the first broadcasting in TV. Some programs are more likely to be available on unauthorised media. In particular, content such as films and TV series may already be available online even before their first broadcasting in TV, de facto replacing views on DTT channels with not authorised views on the Internet (direct volume effect).¹⁷ This has an obvious negative impact on the number of viewers.

The monitoring activity carried out for Mediaset on content protected by copyright on the platforms Facebook, Fanpage.it and Guardaserie.news provides a first indication of how pervasive the phenomenon of unauthorised use is in this area of activity and thereby the damage it causes to Mediaset. In particular, 17,206 violations were found on Facebook, corresponding to a duration exceeding 54 days of programming (precisely 78,766 minutes) related to TV series, entertainment programmes and news programmes. The three titles with the highest number of violations are “Amici” and “Uomini e donne” and the TV series “Centovetrine”, respectively with 4,292, 3,749 and 4,114 reported URLs. The case of Fanpage.it is analogous. Even if the number of violations found in December 2015 is lower (400), in this site and its sub-domains too the presence of unauthorised material is relevant: 96 videos for a total duration of 2 hours and 24 minutes.

Of particular importance, lastly, is the case of the internet site Guardaserie.tv, which gives all the links to the URL where viewers can access various episodes of Mediaset programs in on the hosting platforms RapidVideo and FastVideo . There were 433 violations found in this site in February 2016, lasting for a total of 499 hours and 6 minutes - in other words an average duration of about 70 minutes per violation, thus suggesting that they correspond to entire episodes of the TV series produced and distributed by Mediaset. The two TV series peaking in this particular classification are “Distretto di polizia” and “I Cesaroni”, two of Mediaset’s historical shows with the highest number (and longest duration on aggregate) of violations (Figure 4.6). The damage that such violations have caused to Mediaset is explained in Box 2.

Figure 4.6 – Number of violations for the 10 Mediaset TV series most present on Guardaserie.news



¹⁷ The indirect volume effect shall probably be more contained for Free-to-air, given that both authorised and unauthorised use envisage the same monetary expenditure (zero), even if not the same price given that authorised use envisages advertisements which generate disuse for the viewer.

Source: Lear

The prevalence of unauthorised usage (volume effects) does not affect the various categories of viewers in the same way. FAPAV and IPSOS (2011) build, on the basis of a survey, a typical profile of a “pirate”: pirates are mainly males (56% of the total pirates); young (74% less than 45 years old; 24% between 15 and 24); and with a high level of education (74% of the pirates have achieved a diploma or higher educational qualification).

This social-demographic groups are also among the most attractive for advertisers, because they include subjects with greater spending power (men from 25 to 44 years old with a relatively high level of education); and those contributing to defining trends and fashions prevailing in consumer choices more than others (adolescents and young people under 25). This contributes to further reducing the advertisers’ willingness to pay.

If the first broadcasting only has an impact on some categories of content (for example cinematographic products, already widely available online before being aired), a secondary exploitation by means of subsequent broadcastings in TV, predisposition of DVD collections and transmission via Internet (e.g. through the Mediaset Video platform) is indiscriminately affected by unauthorised usage. Indeed, after having been broadcasted the first time, Mediaset content can be easily “captured” and uploaded online, making unauthorised usage a perfect substitute for other authorised usage, removing value from the secondary channels of exploitation and monetisation.

For example, on a well-known Internet platform for video sharing, Mediaset discovered the presence of 18,561 videos with copyrighted content, uploaded between 2011 and 2015 and with an average period of permanence on the platform equal to 366 days (calculated as the difference between the date of uploading and that of discovery). These 18,561 videos refer to 73 Mediaset programmes; of these, 80% is represented by clips; 20% is represented by full episodes of Mediaset programmes such as *Centovetrine* or *Uomini e Donne*. It is clear that the presence of these videos considerably limits Mediaset’s ability to monetize any distribution of this content on TV or online, or the preparation of DVD collections.¹⁸

Box 2 refers to a recent ruling by the Court of Rome; it explains the consideration deemed by the Court as valorisation of the violations related to Mediaset’s Free content. The decision represents a useful case for a more effective protection of copyright.

Box 2 – The Breakmedia case

An encouraging signal for the protection of copyright by producers of content comes from the recent ruling 8437/2016 by the Civil Court of Rome. RTI had discovered, on the Break portal owned by Breakmedia, the unauthorised presence of its content, extracts from Mediaset television transmissions and transmitted in Free mode (the transmissions included, for example, “Buona Domenica”, “Le Iene” and “Zelig”). After having asked Breakmedia to remove the content without success, RTI took legal action for compensation of the damage caused by the unauthorised use of this content.

The Court ruling upholds RTI’s arguments and contains useful indications for an effective protection of copyright. The Court did, in fact, acknowledge that the activity carried out by Breakmedia, analogous to that of other OTTs such as Youtube, cannot be considered as mere hosting, or passive hosting. Indeed, when describing Breakmedia, the Court observes that it concerns:

Not a simple sharing platform, but a portal allowing an easy and varied choice by simple consultation of thousands of clips and/or extracts of films largely the work of third parties not casually issued by users but

¹⁸ For example, the episodes of *Centovetrine* are prepared in DVD collections and sold in this form. See URL: <http://www.fivestore.it/centovetrine-le-piu-belle-storie-d-amore-10-dvd.html>. Fivestore is the division of Mediaset which has developed editorial and merchandising products for television programmes aired on the group’s channels since 2006.

classified and organised into specific categories (music, movies, entertainment etc.) with a direct intervention in content as well with various methods of use and the possibility to choose, within the programme, the part of interest by associating it to other “related” videos.

The Court substantially accepted the analysis carried out by the court-appointed expert, in order to estimate the damage suffered by RTI. The method of estimation was that of the reasonable royalty, interpreted by the Court as the “price that the counterfeiter would have had to pay for having the faculty to use the violated right, the determination [of which] must come about with reference to the business model adopted by the right holder in order to establish what would have been asked and accepted in order to grant such license”. The Court also deemed that given the methods by which Breakmedia used RTI contents, the hypothetical license would have required the acquisition of full “editorial control” over RTI content (a sort of blanket license) and the price should thereby reflect this circumstance.

The price of consent was therefore quantified on the basis of contracts stipulated by RTI with other parties active in the online sector and that they envisaged the transfer of editorial control - thereby having Mediaset’s business model as natural reference. In particular, the court-appointed expert, and the Court deemed that the damage could be quantified by using a price of 730.25 Euros per minute of audiovisual content made available on the platform. If this criterion were to be applied to the violations identified on the Guardaserie.tv site discussed hereabove, corresponding to a total of 499 hours and 6 minutes, the damage suffered by RTI would be equal to about 22 million Euros.

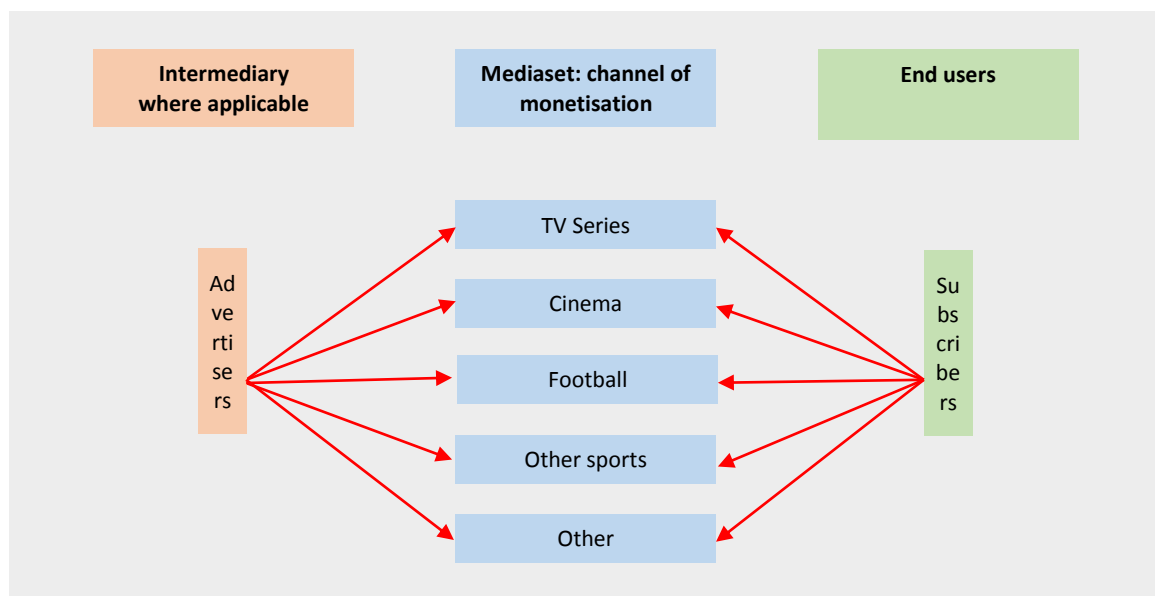
Lastly, the ruling established that Breakmedia had to compensate RTI also for the expenses it sustained for ascertaining the violations; hence it imposed Break media to refund RTI’s monitoring costs related to the case at issue - implicitly acknowledging the iniquity of leaving the burden of enforcement to the broadcasters.

4.2.3. Pay TV (Mediaset premium)

Mediaset, again through RTI, manages a pay TV platform called Mediaset Premium. On a monthly subscription base, Mediaset Premium offers the public audiovisual content of various types including cinema (over 2,500 movies per year), TV Series (in HD, original language and with subtitles), football (Championship Serie A Tim and UEFA Champions League), other sports (such as Superbike), documentaries and children’s programmes.

The sources of revenue for this area of activity are mainly subscriptions, and advertising to a lesser extent. These channels of monetisation are the same for all types of content (Figure 4.7), however the intensity of the effect due to unauthorised usage may vary according to the type or content, as shall be described below.

Figure 4.7 – Pay TV: channel of monetisation

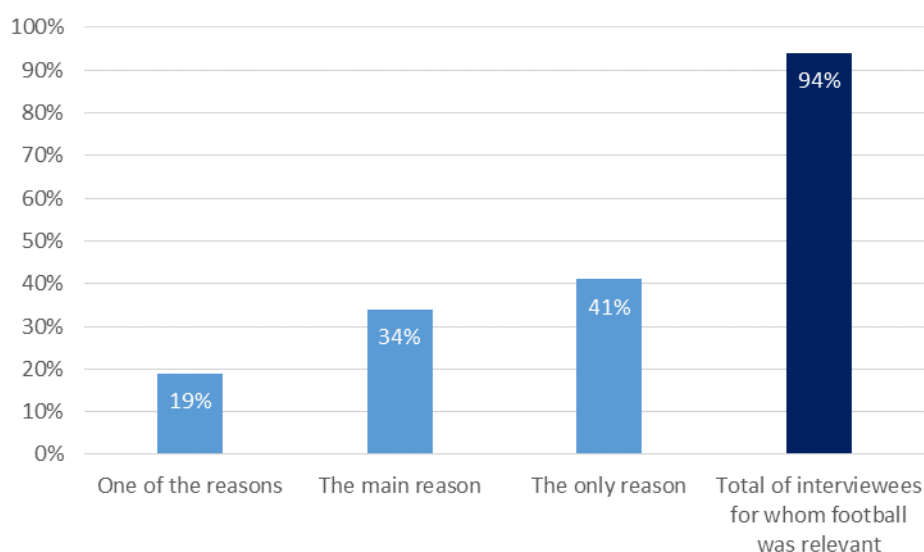


Source: Lear

For Cinema and TV Series, Mediaset's channels of monetisation are threatened by the availability of the same content, or similar content on unauthorised channels, as discussed previously in 4.2.1 and 4.2.2, with the difference that a reduction in subscribers and their related revenues shall correspond to a decrease in advertising revenues, given that as subscribers decrease, so does the audience of viewers reachable by the advertisers.

Football and Other sports are the content driving Mediaset's pay-tv commercial proposition. The availability of football games is the exclusive or main reason for 75% of households to subscribe; for 94% of the subscribers, football is at least one of the reasons they subscribe (Figure 4.8).

Figure 4.8 – Football offer as a reason for subscription to Mediaset Premium

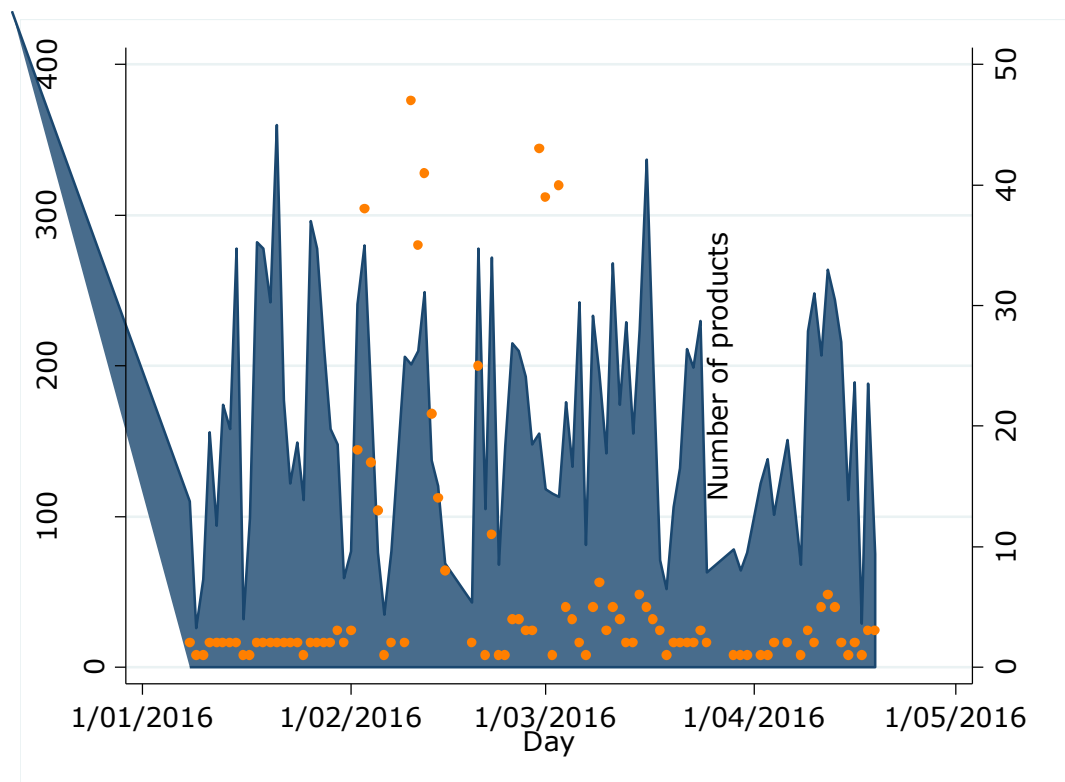


Source: Lear processing on GFK Eurisko Survey, 2013

As demonstrated by the reports on the monitoring activity performed for Mediaset, the profitability of Mediaset's pay services is threatened by the activities of websites or apps supplying, by payment or gratuitously, access to entire lists of Mediaset Premium channels. Furthermore, Mediaset undergoes competition for football content, this too apparently illegal, from streaming services or aggregators of streaming services such as Rojadirecta TV, <http://www.ronaldo7.net/> and <http://www.socceryou.com/>. The presence of these services can influence the choice of potential subscribers and consequently negatively affect the revenues from advertising. This threatens Mediaset's ability to recoup the huge investments it has made especially for the acquisition of TV sport rights.

Figure 4.9 shows the results of monitoring related to premium content between 8 January and 17 April; this concerns, in particular, monitoring carried out on films and sporting events for which Mediaset holds the rights - the monitored titles contain, for example, the movie "Quo Vado" and Serie A and Champions League matches played over that period. Along this lapse of time, lasting only 93 days, a total of 15,048 violations were discovered - equal to about 162 violations per day. Figure 4.9 shows the number of violations (in blue, left axis) together with the number of titles/products to which the violations refer (in orange, right axis).

Figure 4.9 – Number of violations detected



Source: Lear processing on Mediaset data

Lastly, as discussed in section 2.1, Mediaset is also active as an OTT, both with Video Mediaset (AVOD Model) and Infinity (SVOD model). Video Mediaset offers free repeats and clips from television programmes in the Mediaset catalogue; Infinity is a video on demand service offering a catalogue of more than 5,000 titles between movies, fiction, TV series and cartoons on a monthly subscription basis.

The two online services are characterised by the same channels of monetisation as Mediaset Premium. However in this case the competitive pressure exercised by unauthorised distributors is even more intense. Indeed, the two online offers - that authorised and that not authorised - share the same characteristics and therefore have substantially the same potential segment of viewers.

4.3. Monitoring costs

Mediaset carries out a series of activities aimed at monitoring the unauthorised presence of its audiovisual content on OTT platforms and to prevent the continuation of such exploitation. These activities can be classified as follows:

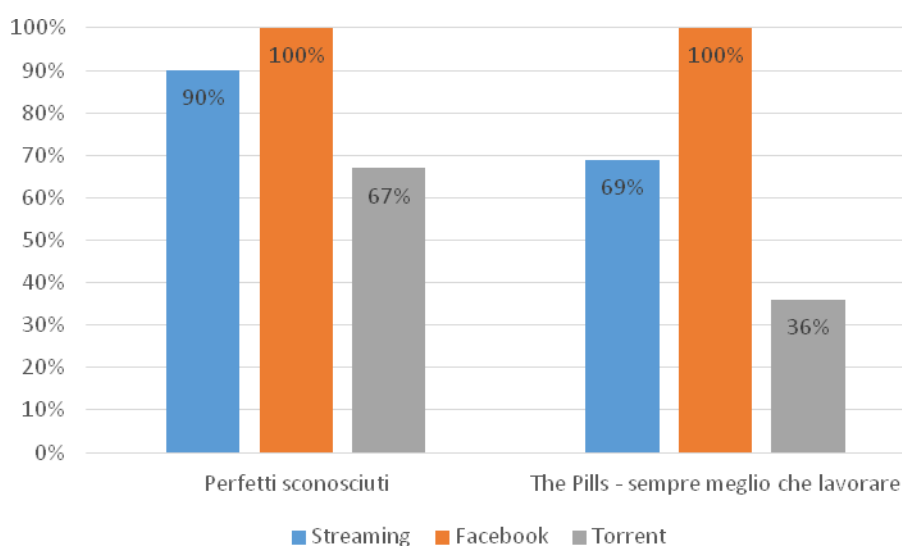
- Preparation of videos compatible with the YouTube Content ID technology or similar instruments to be delivered to YouTube or other OTTs;
- Monitoring OTT platforms or torrents to identify unauthorised Mediaset content (outsourced activity);
- Report to OTTs or search engines of the results from the point above so that they proceed with removing or delisting content under violation;
- Reporting to AGCom, where applicable;
- Legal action taken for compensation of damage and inhibition of illegal conduct.

Such activities, that aim at reducing the damage caused by the unauthorised presence of audiovisual content, give rise to significant costs. These are direct monetary outlays for activities that are outsourced to monitoring companies and external legal consultants; as well as allocation of time and resources for the activities carried out by Mediaset internally.

The monitoring activities described above, the results of which in terms of identified violations were given in paragraph 4.2 as examples related to Mediaset's various businesses, are not sufficient to solve the problem of the online presence of unauthorised content. In particular, with reference to the movies "The Pills – sempre meglio che lavorare" and "Perfetti sconosciuti", released in February and March 2016, it is possible to observe that, in many cases, the reported content was not removed and that the time needed for removal is not negligible at all.

Figure 4.6 shows the effectiveness of the notices of warning in the various channels for the two analysed titles. It is clear that the violations present in Facebook prove to be much easier to remove compared to those identified in websites where streaming was available or which allow the download of Torrent files. Lastly it must be stated that even when it takes place, the removal of reported content is not immediate. Indeed, the average duration ranges from 2 to 3 days from notice and the shortest is 4 hours for violations related to both the considered titles. Whereas the maximum time required for removal was 17 days for "The Pills – sempre meglio che lavorare" and 8 days for "Perfetti sconosciuti".

Figure 4.10 – Effectiveness of cease-and-desist notices by type of channel



Source: Lear

This data raises concern given that not only producers of content suffer damages from copyright violations on Internet and must support costs for minimising such damage, but they do not even have fully effective means to protect their rights in the cases in which they discover the violation.

5. The creation of imbalance and consequences on investments

The proliferation of audiovisual piracy on the one hand and inadequacy of the regulation of the audiovisual system on the other hand result in the generation of an unsustainable imbalance in the medium and long term. Broadcasters contribute to a non-negligible part of the national GDP and to the creation of monetary and cultural value, as described in this section

However two factor are likely to progressively reduce broadcasters' ability to retain the revenues that would normally stem from their investment: the presence of competitors that do not have to comply with the same rules as broadcasters; and piracy. Indeed, over the last five years broadcasters experienced a progressive decrease in revenues, approximately one billion Euros, above all from advertising. Such revenues partially went to OTTs, especially video-sharing platforms, as explained in section 5.2.

The consequences to the profitability of the sector and the Mediaset group are already visible, as illustrated by the analysis of revenues and value of rights in the financial statements in section 5.3. This proves that in the medium and long term f the current market structure, that result from an inadequate regulation and poor copyright enforcement, is not sustainable.

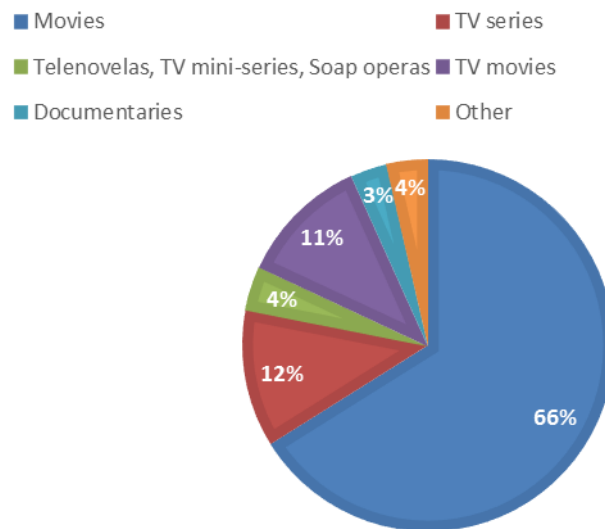
5.1. *The creation of value*

The Mediaset group and, in particular, the subsidiary RTI, possesses one of the most important libraries of television rights in Italy and Europe. RTI selects the projects and produces films for TV, miniseries or TV series for national and international television and distribute this content over its free and pay channels. The subsidiary Medusa (Medusa Film S.p.A.), instead, is a leading company in the Italian market of cinematographic distribution.

In 2014, RTI acquired approximately 9,660 titles (5,662 of which for Free TV and 3,998 for Pay TV). During the the same year, the company also realised huge investments in the acquisition of sports rights, in particular for the exclusive rights to transmit the matches of the UEFA Champions League for seasons 2015/2018 and to transmit the Serie A championship for seasons 2015-2018. RTI also realised 301 original productions to be distributed on generalist, thematic and pay networks.

The following Figure provides details of the type of rights acquired in 2014. More than 50% of the acquired titles concern movies, followed by television series and TV movies.

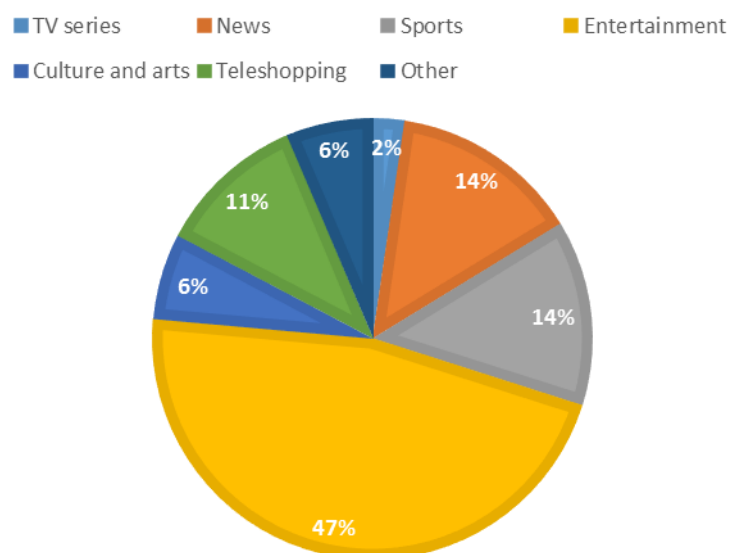
Figure 5.1 – Typology of titles acquired by RTI for Pay TV and Free TV



Source: Lear processing from the consolidated financial statements of Mediaset 2014

Figure 5.2 gives a breakdown by type of productions realised by RTI in 2014. Almost 50% of the productions pertain to the entertainment sector - – *C'è posta per te*, *Amici*, *PomeriggioCinque*, *MattinoCinque*, *Uomini e Donne*, *Le Iene*, *Il Grande Fratello*; followed by Sport and News – *Tg5*, *Studio Aperto*, *Tgcom 24*; and lastly Telesales.

Figure 5.2 – Typology of productions realised by RTI



Source: Lear processing from the consolidated financial statements of Mediaset 2014

In relation to cinematographic distribution, in 2014 the total Box Office takings for films distributed by Medusa were 575 million Euros corresponding to 91 million tickets sold.¹⁹

Broadcasters, amongst which Mediaset, RAI and Sky, contribute to the creation of television and cinematographic content to a decisive extent. A large part of the financial value generated by television and the number of personnel it employs is attributable to broadcasters. The sector is literally “driven” by the revenues from these operators, which comprehensively generated 70% of the direct revenues in 2014 and gave work to more than 90% of the direct employees.

According to a recent study by Ernst & Young, in 2014 the TV and Home Entertainment sector ranks as the first sector for financial value within the Italian cultural industry, with a financial value equal to 12.2 billion Euros. In the same year, the sectors of culture and creativity generated a comprehensive financial value of 46.8 billion Euros, contributing to 2.9% of the Italian Gross Domestic Product. The following table shows the financial value accounted for by each of the sectors within the culture and creativity industry (there may be instances of double counting where two sectors share part of their value chain).

Table 5.1 – Financial value of the sectors of the culture industry

Sector	Financial value 2014 (€ billion)
Television and Home Entertainment	12.2
Visual Arts	11.2
Advertising	7.4
Newspapers and Magazines	5.1
Performing Arts	4.5
Music	4.3
Books	3.1
Videogames	2.9
Architecture	2.6
Cinema	1.7
Radio	0.8

Source: Lear based on Ernst & Young data, 2016.

The importance of the industry of culture and creativity also emerges when compared with other economic sectors. In 2014 the industry of culture generated a direct financial value²⁰ exceeding the

¹⁹ Among the most relevant films of the year: the film with Aldo, Giovanni and Giacomo, “Il ricco, il povero e il maggiordomo”, which took 13.1 million Euros; “Andiamo a quel paese” with Ficarra and Picone which took 8 million Euros; “Tutta colpa di Freud” by Paolo Genovese, with 7.9 million Euros. From the qualitative viewpoint one cannot forget the victory of the Oscar won by Paolo Sorrentino with “La grande bellezza” in the category of best foreign film in 2013: thanks to the prompt broadcasting on Canale 5, the film reached an audience such as to become the film most seen in the last 10 years.

industry of telecommunications (39 billion Euros) and just below the automobile industry (49 billion Euros). Therefore, from this viewpoint, Mediaset, Sky and RAI must be considered as the main players in one of the driving sectors of the industry of culture: television.

The broadcasting and cinema industry contributes significantly to the national economy also by creating jobs. The table below shows the number of people employed in the cinema and broadcasting sectors. Mediaset and other broadcasters have directly given jobs to 127,000 people in Italy, against the 200 employed by OTTs (not related by broadcasters)²¹.

Table 5.2 – Employment generated by Broadcasters/Cinema and OTTs – 2014

Phase of the value-chain	People employed ('000)
Production and post-production (A)	33,4
Performers (B)	39,5
Direct employees of broadcasters (C)	38,3
Movie Theaters (D)	10,4
Movie and TV shows distribution (E)	1,2
DVD Blu-ray (F)	3,5
TV, cinema and journalism schools (G)	0,7
People directly and indirectly employed by <i>broadcaster/cinema</i> (A + B + C + D + E + F + G)	127
People directly and indirectly employed by independent OTT TV	0,2

Elaborazione Lear su dati (Ernst & Young 2016)

In other words, almost 100% of jobs in the TV and Cinema sectors in Italy directly or indirectly is created by broadcasters²². This disproportion in the number of employees is caused by several factors. First, most of the OTTs, even after entering into the Italian market, have continued to manage the Italian division from their headquarters, normally in the United States, with a minimal integration in Italy. In addition, this disproportion reflects the gap in terms of costs that OTTs can benefit as a consequence – *inter alia* – of the more favourable regulation they are subject to.

²⁰ The direct financial value indicates added value generated by the single rings in the chain of value (intermediate revenues), given that the value of the work acknowledged by the end client includes the contributions of all the intermediate working phases. This therefore concerns revenues deriving from activities directly linked to the creative chain, such as concept, production and distribution of cultural and creative works and services. Excluded, instead, is the value generated by collateral or subsidiary activities.

²¹ According to the figures available, the total amount of employees created by Google, Apple, Amazon and Facebook, in relation to “all” their activities (not only those related to audiovisual distribution) reaches 2.445 people.

²² Of the 127.000 jobs created by broadcasters, 57% are employed by the Cinema sector and 42% by the TV sector. The remaining 1% is employed in shared activities, such as schools and film and TV programs distribution.

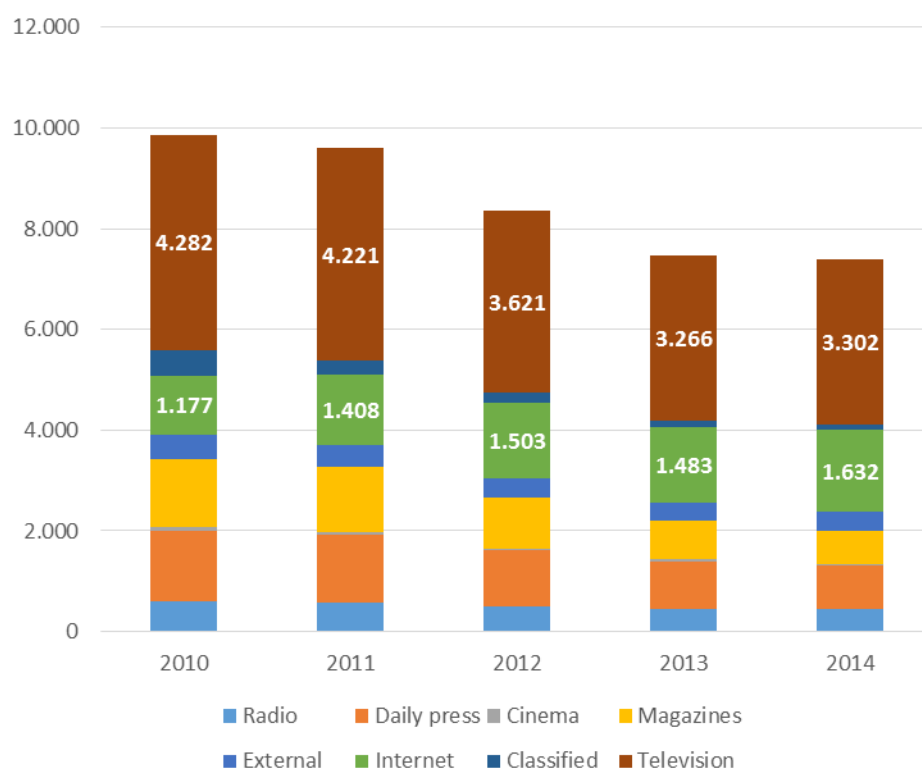
Fiction represents the most significant productions in terms of budget and audience, with approximately 220 million invested in 2014 and intended for independent production houses. The quantification of national, and sometimes international, success achieved by these products should moreover include the promotion of the territory and tourism.

More in general, broadcasters play an essential role to preserve and promote the local culture – on the contrary to OTTs that are almost totally dedicated to the distribution of foreign productions. In addition, broadcasters contribute to the national political, social and cultural debate through their news offer, which is substantially absent from OTTs offer.

5.2. Advertising income and the creation of an imbalance

In recent years, according to the AGCOM Annual Report 2015, the media sector was characterised by a general decline in terms of advertising revenues. Nonetheless the negative trend did not concern all media. The Internet, unlike other media, recorded a positive change in advertising revenues in the period 2010-2014 (Figure 5.3).

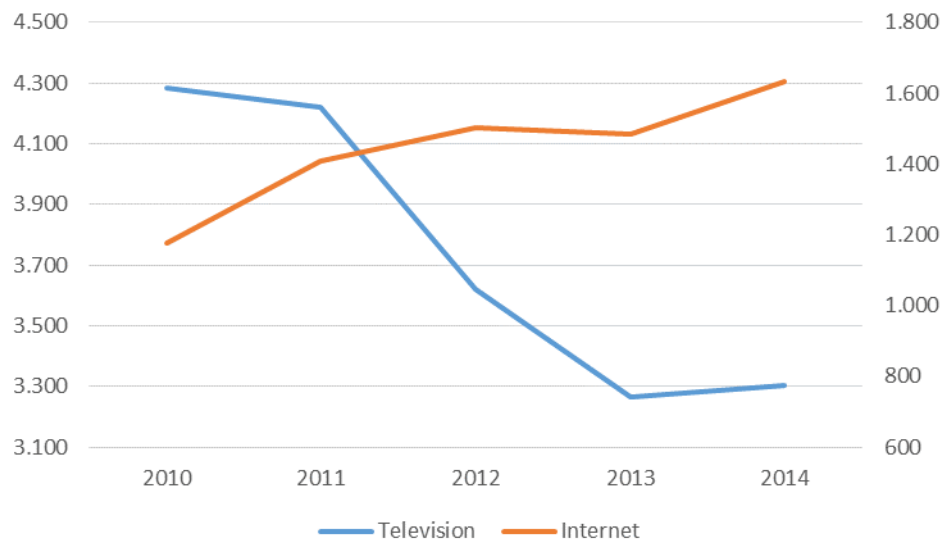
Figure 5.3 – Dynamics of advertising income per means (mln €)



Source: Lear processing on AGCom Annual Report 2015

Figure 5.4 compares advertising income exclusively for television and the Internet. Whilst takings from advertising on the Internet have significantly increased, from 1.2 billion in 2010 to more than 1.6 billion in 2014, those from the TV have fallen by almost 1 billion Euros, from 4.3 billion to approximately 3.3.

Figure 5.4 – Dynamics of advertising income for Television and Internet (mln €)

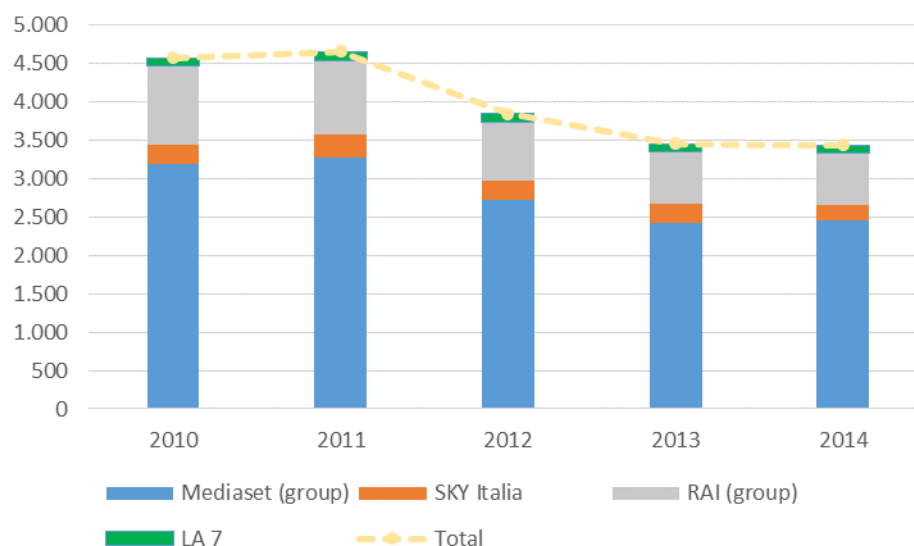


Source: Lear processing on AGCom Annual Report 2015

The digital offer of audiovisual services has captured the attention of advertisers. Digital platforms attract a growing number of users, allowing a larger slice of demand to be captured. The digital offer, moreover, being typically thematic, allows advertisements to be adapted to the type of expected user.

Operators such as Mediaset, Sky and RAI, collect a constantly lower portion of advertising revenues. Figure 5.5 shows the trend in advertising income in the period 2010-2014 for Mediaset, Sky, RAI and LA7. Advertising revenues for Mediaset have decreased by about 23%; RAI, on the other hand, suffers a drop of about 34%. Sky and LA7, lastly, show a more contained fall.

Figure 5.5 – Trend in advertising income for the main broadcasters in Italy



Source: Lear processing on Mediobanca data 2015

The trend in advertising expenditures highlights the existence of a profound imbalance in the Italian audiovisual market. Digital platforms, in particular the distributors of unauthorised audiovisual content (Youtube, Vimeo), gain an increasing percentage of advertising revenues but do not invest in the production of original content. In the medium and long term, this trend could strengthen: a recent study claims that advertising investments in online TV will record an annual growth rate of 29% in the five year period 2014-2019, whereas those on TV shall only grow by 2% per annum.²³

The lack of revenues for broadcasting industries could lead, in the medium term, to a decrease in investments in original content and, ultimately, to the impoverishment of the audiovisual system - not only to the detriment of Mediaset and the other operators, but also the public. In the short term viewers have benefitted from constantly lower or null prices in order to watch audiovisual content. It is evident, however, that this trend cannot be sustained.

As widely discussed in the previous sections, the current regulatory framework is not apt to correct the formation of such imbalance, but, on the contrary, it creates it. The AVMS Directive and the E-commerce Directive generate, in fact, conditions of asymmetrical competition between the operators of the audiovisual market. Furthermore, the presence of an inadequate system for copyright enforcement discourages the activities of broadcasters and, in particular, investment in original content.

5.3. The reduction in revenues and investments by Mediaset

The evolution of the audiovisual ecosystem has been accompanied by a profound imbalance in the market. Regulatory asymmetry in favour of OTT operators and the presence of an inadequate system for copyright protection have gradually brought about a reduction in broadcasters' revenues. Market development has, instead, favoured an increase in unauthorised distributors of content protected by copyright, such as Youtube and Dailymotion.

Higher revenues from digital operators are not allocated to the production and acquisition of content and the creation of value. The business model of some OTT operators, as a matter of fact, is partially based on the unauthorised exploitation of the content of others. The higher takings by OTTs do not compensate the lower earnings of the broadcasters because the manner in which the former operate strips the content of its value. In the medium and long term, operators such as Mediaset, Sky, RAI shall have increasingly less resources to invest in the creation of content and shall no longer be able to feed the audiovisual ecosystem.

For the purposes of illustrating the formation of the imbalance just described, Mediaset's trend in business can be analysed by taking into consideration two main values :

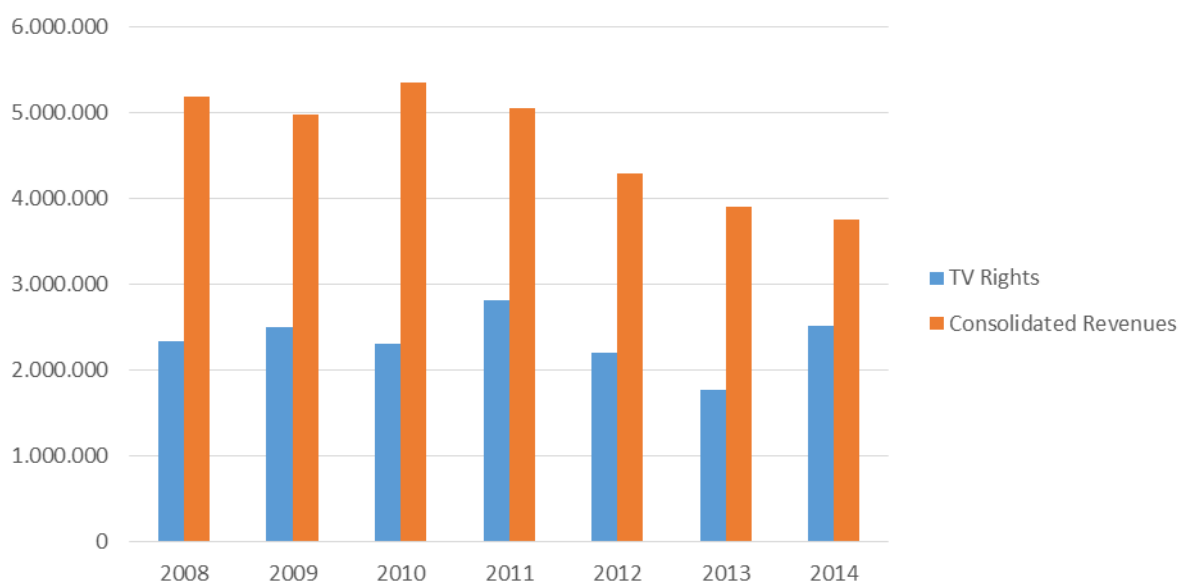
- The consolidated net income, equal to the financial value generated by Mediaset's business;
- The investments in the acquisition of television and cinematographic rights, equal to the book value of the corporate library of the Mediaset group, i.e. the value of the group's main corporate asset.

As observed from the following figures, revenues assume a decreasing trend, mainly retraceable to the reduction in takings from advertising - as examined in section 5.2. The reduction in revenues is accompanied by a progressive decrease in the value of the corporate library, a symptom of a drop in investments. Corresponding to the reduction in revenues, in fact, is a lower availability of resources to be invested in the creation of value. Developments in the audiovisual markets and the growth of OTT operators risk creating a vicious circle, leading, in the long term, to the impoverishment of the

²³ PwC, "Key highlights. Entertainment & Media Outlook in Italy 2015-2019", 2015.

market. Figure 5.6 shows the trend in revenues and the book value of Mediaset's library for the TV offer.²⁴

Figure 5.6 – TV: trend in Mediaset's business



Source: Lear processing on the consolidated financial statements of the Mediaset group

The decreasing trend in revenues began from 2010. The trend in the value of televisions rights, however, shows a generally decreasing trend with intervals of temporary recoveries. The temporary increase in the value of rights in 2009, 2011 and 2014 can be fully attributed to the acquisition of sports rights:

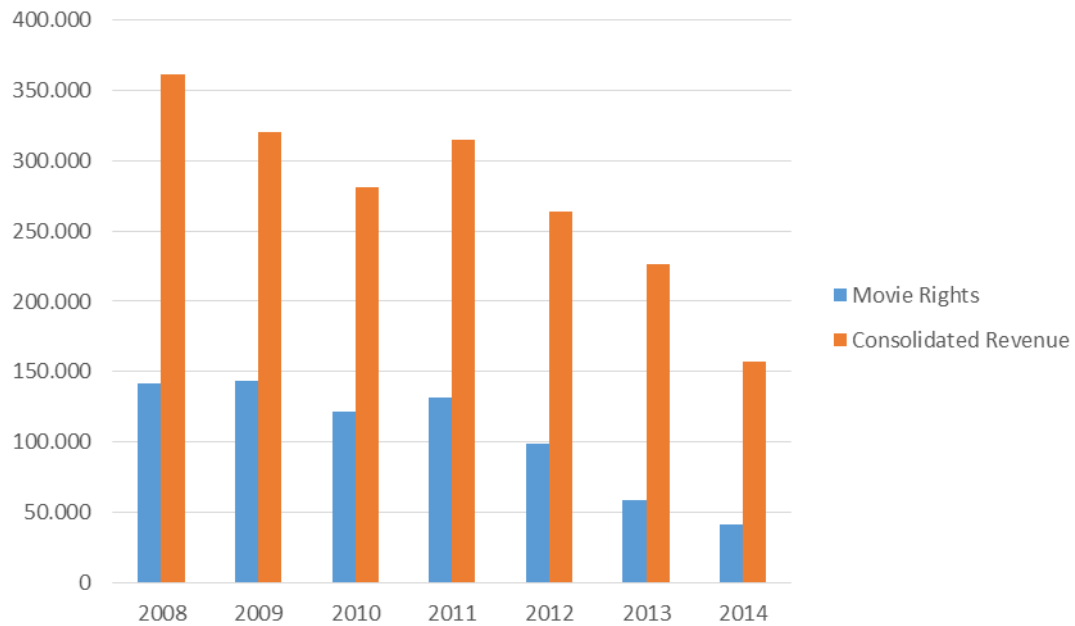
- In **2014**, the Mediaset Group invested 1.1 billion Euros for the rights to transmit the Serie A championships for seasons 2015-2018;
- In **2011**, the Mediaset Group invested approximately 836 million Euros for the rights of transmission on DTT pay channels the matches in the Serie A championship for football seasons 2012- 2015;
- In **2009**, the Mediaset Group invested approximately 435 million Euros for the rights transmission on DTT pay channels the matches of 12 clubs in Serie A related to football seasons 2010-11 and 2011-12.

As for Cinema²⁵, the reduction in earnings and value of the corporate library is much sharper. The value of cinematographic rights changes from 141 to 41 million from 2008 to 2014, suffering a percentual reduction equal to approximately 70%.

²⁴ The calculation considers the following group subsidiaries: RTI SpA, Publitalia, Digitalia and, for 2014, Mediaset Premium.

²⁵ The calculation considers the companies Medusa Film and Taodue s.r.l. Taodue is also engaged in the production of fiction, however it contributed to the realisation of relevant works for the cinematographic distribution of Mediaset, such as Quo Vado in 2015.

Figure 5.7 – Cinema: trend in Mediaset's business



Source: Lear processing on the consolidated financial statements of the Mediaset group

In conclusion, the transformation of the Italian audiovisual market and asymmetric competition of OTT operators has negatively affected the turnover for Mediaset and discouraged investments in television and cinematographic rights. The decline in turnover is in fact accompanied by that of the value of rights, which shows a declining trend, with the only exception of sport TV-rights.

6. Conclusions

The imbalance which has been created in recent years in the audiovisual market will be unsustainable in the medium term. Mediaset has already started decreasing its investments in the creation and acquisition of content, in response to the negative trend in revenues deriving from the reduced takings from advertising and the decline in other sources of income.

Mediaset's case is symptomatic of the more general situation into which the producers of original content are falling. The risk, in the medium term, is that of the creation of a void in the production of audiovisual content. OTTs are replacing broadcasters, without however replacing them in the crucial production of cultural content - not only to the detriment of Mediaset and other broadcasters, but ultimately of the end customers.

Not only do policy makers fail to protect broadcasters from continued violations of their copyrights, leaving the cost of enforcement to such broadcasters, but they feed the imbalance by imposing rules that have favoured ambiguity in attributing legal responsibility for copyright violations and created a position of competitive disadvantage for the broadcasters.

These choices are short-sighted. Innovation cannot exist without the protection of those that generate it: the copyright instrument meets this requirement, but it is an instrument that is essentially void when the existing rules make its enforcement impossible or financially unsustainable.

Policy makers are facing market failure, given that nobody shall sustain the huge costs of innovation if they are incapable of collecting the revenues these investments can generate. The impoverishment of Mediaset and other broadcasters would not be a problem per se: markets change, as the operators working in them change, within a process that is generally the sign of good market operations as well as their ability to produce innovation.

It becomes a problem, though, when the entity taking the place of the broadcaster has shown to be incapable of contributing to the cultural offer. If so, the negative effects on Mediaset and other broadcasters will eventually result in the impoverishment of the cultural industry as a whole.

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