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FEDERAL TRADE COMMISSION

PUBLIC WORKSHOP  
PEER-TO-PEER FILE-SHARING TECHNOLOGY:  
CONSUMER PROTECTION AND COMPETITION ISSUES

Thursday, December 16, 2004

9:00 a.m.

Federal Trade Commission  
Sixth and Pennsylvania Avenue, N.W.  
Washington, D.C.

For The Record, Inc.  
Waldorf, Maryland  
(301) 870-8025

## FEDERAL TRADE COMMISSION

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1           Think back, if you will, to the time when the  
2           automobile was first introduced. Some horse owners and  
3           sellers urged that cars might hurt horses and their  
4           riders, and that new vehicles therefore should be banned  
5           entirely.

6           Of course, other solutions emerged to promote  
7           safety while allowing consumers to benefit from that  
8           promising new technology. And as with the automobile, it  
9           is my hope that faith and responsible solutions, too,  
10          will emerge in the peer-to-peer context. So that the  
11          future of this promising new technology also will  
12          flourish.

13          As Chairman Majoras noted yesterday, a  
14          discussion of P-to-P issues is both important and timely.  
15          She also explained that the Federal Trade Commission is  
16          particularly well-positioned to host this workshop  
17          because peer-to-peer file-sharing technology implements  
18          and implicates both the consumer protection and the  
19          competition matters, and new issues certainly will emerge  
20          as the technology continues to develop.

21          As part of our consumer protection mission, the  
22          FTC must remain vigilant in protecting consumers against  
23          unfair trade practices, deception, and anti-competitive  
24          conduct.

25          But in order to remain true to our mission, we

1 also must take care not to pursue, create, or condone  
2 policies that inadvertently impede the evolution and  
3 adoption of useful new technologies to the long run  
4 detriment of consumers and businesses.

5 Our goal in sponsoring this workshop is to  
6 bring together individuals and groups who develop and use  
7 peer-to-peer technology, as well as those whose existing  
8 business models are affected by it, to ensure that  
9 policy-makers and the public are as well-informed as  
10 possible.

11 Yesterday's panel set a very high bar, and we  
12 expect an equally high level of discussion from this  
13 morning's panelists, who will focus on some of the  
14 intellectual property questions that arise in the  
15 peer-to-peer context.

16 Today's panels will look at the impact of  
17 P-to-P file-sharing technology on several groups: on  
18 industries that rely heavily on copyright protection; on  
19 consumers who use the technology; on businesses that  
20 redistribute the copyrighted material; and on artists  
21 whose work is copyrighted.

22 The first panel will examine the impact of  
23 peer-to-peer file-sharing technologies on the copyright  
24 holders. Representatives from the legal, economic, and  
25 engineering communities will explore a key question, and

1 that is, how to protect the property rights of creative  
2 individuals without stifling technological evolution that  
3 could benefit consumers and enhance business efficiency.

4 Balancing these competing interests is likely  
5 to require some new thinking about the law. For example,  
6 the panel will address whether copyright laws might be  
7 amended to better accommodate property rights in the  
8 P-to-P context as well as the possibility of using  
9 innovative licensing agreements, or perhaps standard-  
10 setting processes, to facilitate solutions to the  
11 balancing problem.

12 I expect that the panelists will have many  
13 different ideas about the teachings of the Ninth  
14 Circuit's recent Grockster decision, which the Supreme  
15 Court recently agreed to hear.

16 In addition, the panel will consider the use of  
17 evolving technologies that peer-to-peer providers could  
18 use to protect against content degradation and copyright  
19 violations.

20 I am particularly interested in hearing the  
21 unique perspectives of panelists who own copyrights, and  
22 who innovate by using works whose copyrights have  
23 expired.

24 For example, when a copyright expires on a  
25 classic copyrighted work, such as Charles Dickens, A



1 Christmas Carol, and a movie is made from it, both the  
2 motion picture industry and consumers may benefit.

3 Overall, this session today should be very  
4 informative and highly thought provoking.

5 Our second panel will focus specifically on the  
6 experiences of the music industry since the emergence of  
7 the peer-to-peer file-sharing technology. However, this  
8 information may also help to foster a more general  
9 understanding of challenges faced by other industries,  
10 such as software, gaming, television, and motion  
11 pictures.

12 The panel includes artists, copyright holders,  
13 representatives of peer-to-peer groups, economists, and  
14 others. They will share their diverse perspectives on  
15 the impact of peer-to-peer file-sharing on pre-recorded  
16 music sales.

17 They will discuss current business models, as  
18 well as potential new models that are likely to arise as  
19 consumers increase their use of peer-to-peer file-sharing  
20 networks. And I expect, again, today a spirited exchange  
21 of ideas during this second session.

22 The Pugh Internet, an American Life Project,  
23 has just released a study on "artists, musicians, and the  
24 Internet." According to that study, artists have, and I  
25 quote, "embraced the Internet as a tool that helps them

1 create, promote, and sell their work."

2 The study also found, however, that artists are  
3 divided about the impact and importance of free file-  
4 sharing and other copyright issues. Take, for example,  
5 one of the public comments the Commission received in  
6 anticipation of this workshop.

7 It came from an artist who, in order to  
8 generate interest in his work, offered all of the music  
9 of his first album for free to anyone who wished to remix  
10 his music.

11 According to his comments, remixers used his  
12 tracks around the globe. As this example demonstrates,  
13 peer-to-peer technology may offer great rewards for  
14 artists, for copyright holders, and for music lovers  
15 alike.

16 However, it will achieve its greatest promise  
17 only if all parties can agree on a system that fairly  
18 compensates artists and copyright holders for the value  
19 of their creative work.

20 Hopefully, our panelists will consider whether  
21 the motion picture and recording industries are equally  
22 likely to be able to work collaboratively with proponents  
23 of peer-to-peer technology to achieve maximum benefits  
24 for consumers and artists alike.

25 So let me close by saying once again how very

1 pleased I am by your interest and by your participation  
2 in this peer-to-peer workshop. On behalf of the  
3 Commission, I offer my sincere thanks to all of the  
4 panelists, and I hope you enjoy today's program. Thank  
5 you.

6 (Applause.)

7 MR. PAHL: Thank you, Commissioner Harbour. I  
8 would like to begin now with our first panel, which is  
9 peer-to-peer file-sharing and its impact on copyright  
10 holders. The moderator of this panel is John Delacourt,  
11 who is chief anti-trust counsel in the FTC's Office of  
12 Policy Planning.

13 If John and the panelists could come forward,  
14 that would be great.

15 MR. DELACOURT: Good morning, everyone, and it  
16 looks like we have a good crowd again today. And I would  
17 like to take this opportunity to thank all of you for  
18 joining us this morning.

19 Our first panel this morning, as Commissioner  
20 Harbour indicated, is on P-to-P file-sharing and its  
21 impact on copyright holders. This issue, perhaps more  
22 than any other, has generated interest in P-to-P networks  
23 and inflamed strong passions on all sides.

24 Content providers are, not surprisingly,  
25 concerned about the sheer scope of P-to-P piracy of

1 copyrighted music and videos. This activity not only  
2 results in substantial revenue losses, which some  
3 estimates place in the millions of dollars, but  
4 potentially reduces the incentives of the creative  
5 community to generate more and better original works.

6 Users of P-to-P networks, in contrast, contend  
7 that the impact on copyright holders has been  
8 exaggerated. Many of them are deeply offended by what  
9 they regard as heavy-handed enforcement efforts, which  
10 seem to pit major record labels and movie studios against  
11 individual college students. They argue that the content  
12 providers should spend more time thinking about how to  
13 better use this emerging channel of distribution and less  
14 time thinking about how to shut it down.

15 Technology companies have also raised concerns.  
16 While generally supportive of strong copyright  
17 protection, they argue that enforcement efforts should be  
18 focused on bad actors, not the technology itself. In  
19 other words, technological solutions to the copyright  
20 infringement problem can and should be explored, but  
21 content providers should not be given a seat at the  
22 design table.

23 Certainly reconciling these different  
24 perspectives is not going to be easy, but luckily we have  
25 with us this morning eight panelists who have all done a

1 lot of thinking on this issue and should have some light  
2 to shed. Hopefully, they will be able to bring some  
3 insights to the file-swapping controversy, and perhaps in  
4 the process also provide some guidance to the U.S.  
5 Supreme Court, which, as Commissioner Harbour mentioned,  
6 will shortly be taking up this issue, as well.

7 As many of you know, this week the Court  
8 granted cert in MGM studios v. Grockster, and I suspect  
9 that at least a couple of our panelists will have a few  
10 words to say about that.

11 So just a few words about format before I  
12 begin. Each of the panelists will give a short prepared  
13 statement, and then, subsequent to that, we will be  
14 opening the floor to questions.

15 So let me start with our first panelist, David  
16 Carson. David is the general counsel of the United  
17 States Copyright Office. Prior to joining the Copyright  
18 Office, he was in private practice, where he represented  
19 a wide variety of copyright holders ranging from authors  
20 and recording artists to computer software publishers.

21 David will describe the legal framework in  
22 which P-to-P file-sharing takes place. David.

23 MR. CARSON: Thank you, John. I do have a  
24 Power Point presentation, I don't know quite how to get  
25 to it. Well, that's easy.

1 All right. Well, my assignment this morning is  
2 in six to eight minutes to give you an overview of the  
3 state of copyright law with respect to peer-to-peer file  
4 transmission.

5 Those of you who know anything about it at the  
6 end of this six to eight minutes will complain that it's  
7 been a very superficial and selective account, and I will  
8 plead guilty, but in the time frame I have, there is not  
9 much one can do about that.

10 So let's get right into it. First of all,  
11 let's briefly address the question of whether there is  
12 copyright infringement with respect to peer-to-peer  
13 services. And if you look at it in terms of individual  
14 transactions taking place on peer-to-peer services, I  
15 don't think there's any question but that copyright  
16 infringement does take place on peer-to-peer services.  
17 And that when an individual, without permission from the  
18 copyright owner, causes the copyrighted work to be  
19 transmitted on a peer-to-peer network, and whether as a  
20 recipient or as the person who is making it available for  
21 transmission, that person has infringed.

22 There have been at least two of the exclusive  
23 rights of the copyright owner that have been infringed:  
24 the reproduction right -- an unauthorized copy is being  
25 made on the recipient's computer -- as well as the

1 distribution right, because a copy is being distributed  
2 from one point to another.

3 There may also be an infringement of the public  
4 performance right, depending upon the particular way in  
5 which that peer-to-peer system is operating. If you're  
6 hearing a performance simultaneous with the transmission,  
7 then there would be an infringement of the public  
8 performance right as well.

9 That's pretty much incontestable, I believe.  
10 We'll see, I suppose, in the next 90 minutes.

11 The more interesting question than the one  
12 that's occupying all of our minds at the moment in recent  
13 events and caused us to focus on that question, is  
14 whether a peer-to-peer service or a provider of  
15 peer-to-peer software can be held liable for providing  
16 that software, or that service, if you will. Not because  
17 that service itself is infringing copyright, but because  
18 it is enabling the infringement of copyright.

19 Well, copyright law has long had doctrines of  
20 secondary liability, and in particular there are two  
21 doctrines of secondary liability that have been called  
22 into play in this context.

23 The first is that of contributory infringement.  
24 To be a contributory infringer two things must be true.  
25 One is that you must know that infringing activity is

1 taking place. And the second is that you must make a  
2 material contribution to the infringing conduct of the  
3 person who is actually doing the infringement.

4 When the 1976 Copyright Act was enacted, the  
5 House of Representatives report gave an example: if you  
6 rent a movie to somebody knowing that that person is  
7 going to make an unauthorized public performance of the  
8 movie, then you are liable as a contributory infringer.

9 The second theory is the theory of vicarious  
10 liability. It is essentially similar to and based upon  
11 the notion of respondeat superior. If you have someone  
12 do something for you that is unlawful, then you are  
13 responsible for what they have done as though you had  
14 done it yourself.

15 There are two elements to that. The first is  
16 that you have the right and ability to supervise or  
17 control the infringing activity. And the second is that  
18 you had a direct financial benefit from that activity.

19 A couple of examples that the case law makes  
20 pretty clear is if you're a dance hall operator and you  
21 hire a band to play, and that band plays musical  
22 compositions without authorization of the copyright  
23 owner, you will be liable for their infringements.

24 Another one, if you're an operator of a swap  
25 meet and the people who are selling goods at your swap



1 meet are selling infringing goods, you will be held  
2 liable for their acts of infringement, at least if it's  
3 circumstances where you are getting a direct financial  
4 benefit from their sale, and where you could have stopped  
5 them.

6 So that's sort of the overview. Why do we have  
7 doctrines of secondary liability? Well, a couple of  
8 cases have given us some notions of why. The first is  
9 one of efficiency and practicality.

10 We heard about the many lawsuits filed by the  
11 recording industry, and more recently the motion picture  
12 industry, against individual infringers in peer-to-peer  
13 networks. And there are hundreds, maybe thousands, of  
14 those suits now, but I don't think anyone pretends that  
15 it's begun to stop the problem.

16 And one might imagine that no matter how many  
17 of these lawsuits you file against the individual  
18 infringers, most people aren't going to feel deterred,  
19 because the odds are that you, the individual infringer,  
20 simply are never going to be sued. It's much more  
21 efficient, it's much more practical, to sue the person  
22 who is enabling the infringement by all these other folks  
23 who may be difficult to track down, who may be judgement-  
24 proof. And if you can stop it at the source,  
25 essentially, that is a much easier and more efficient way

1 to stop the problem.

2 The second is simply a notion of fairness. If  
3 you are in fact engaging in an enterprise which you set  
4 up so that you, yourself, aren't engaging in  
5 infringement, but you are profiting from the infringement  
6 of others, then fairness and equity actually suggest that  
7 perhaps you ought to be held responsible for what you've  
8 unleashed, essentially -- for that which you are  
9 profiting from.

10 So those are theories behind these doctrines of  
11 secondary liability.

12 The major case in this area, of course, and the  
13 one that we're all grappling with this year, is Sony v.  
14 Universal City Studios, the Betamax case, which addressed  
15 the video cassette recorder 20 years ago.

16 Now, I can't begin to describe to you what the  
17 Court held, because that would take more time than I  
18 have. But the very, very brief and selective overview  
19 is, first of all, the Betamax was a recording machine,  
20 a machine that allows individuals in the privacy of their  
21 homes to record over that which is being broadcast to  
22 them free and over the air and make personal copies,  
23 which the Court found was predominantly for purposes of  
24 time-shifting. You miss the evening news because you got  
25 home too late tonight, your VCR recorded it so that when

1 you got home, you could watch the evening news, and you  
2 would never watch that particular thing again.

3 The Court, in fact, expressly did not say  
4 whether or not making a personal archive of television  
5 programs that you might want to go back to again and  
6 again was fair use. What it did find was that the  
7 predominant use of the Betamax was time-shifting, and  
8 that that was fair use.

9 The Court found there was no liability for  
10 copyright infringement on the part of the manufacturer of  
11 the Betamax machine, because even though the manufacturer  
12 knew that some of his consumers might infringe, that  
13 wasn't sufficient.

14 And the Court imported into copyright law a  
15 patent law doctrine, the stable article of commerce  
16 doctrine, which says that the sale of copy equipment does  
17 not constitute contributory infringement if that product  
18 is widely used for legitimate, unobjectionable purposes.

19 And then in the passage that has everyone  
20 wondering, all right, what do they really mean, and  
21 perhaps this year they will tell us what they really  
22 meant, the Court said, indeed, it may merely be capable  
23 of substantial non-infringing uses.

24 The question is, thus, whether the Betamax is  
25 capable of commercially significant non-infringing uses.

1           Well, let's shift to peer-to-peer services 20  
2 years later. A number of questions arise. Is  
3 peer-to-peer software a staple article of commerce? If  
4 you're an operator of a peer-to-peer network, are you  
5 liable if you don't have actual knowledge of specific  
6 acts of infringement at the time those acts are taking  
7 place, and at a time when you might be in a position to  
8 stop them? Does a peer-to-peer service have substantial  
9 non-infringing uses, and, if it does, what are the  
10 consequences?

11           Well, we've got three cases from the courts of  
12 appeals that have spoken on this issue. Different  
13 factual contexts, but even putting aside those different  
14 factual contexts, the court took very different  
15 approaches in each case.

16           The Napster case was, of course, a centralized  
17 peer-to-peer service. You heard about that yesterday.  
18 Napster did have actual knowledge of infringing activity,  
19 because it controlled the index which listed all of the  
20 files that were available. And the court found that that  
21 was key in terms of determining that there was liability.

22           Napster had the knowledge and its software  
23 materially contributed to the infringement.

24           The court also found that Napster was  
25 vicariously liable. First of all, it enjoyed a financial

1 benefit from people who used its service, and secondly,  
2 it had the right and ability to supervise its users' use.  
3 It could have blocked their access to the service when it  
4 found out that they were engaging in infringement.

5           2003, the Seventh Circuit took a very different  
6 approach in the Aimster case. In that case, the operator  
7 of the system encrypted the transmission, so it couldn't  
8 know what was going on. It couldn't know what particular  
9 files were being exchanged. But the court found,  
10 nevertheless, there was contributory infringement. It  
11 didn't address vicarious liability. It found that  
12 Aimster knew that its users were engaging in infringing  
13 activity, that setting a system up so that it couldn't  
14 know was simply wilful blindness, and that is as good as  
15 knowing what your users are doing. Therefore, they had  
16 the requisite guilty state of mind.

17           Moreover, the court, interpreting that passage  
18 from Sony that I mentioned earlier, said that it's not  
19 enough to show that a product is physically capable of a  
20 non-infringing use; rather, there is a cost-benefit  
21 trade-off that you have to go through.

22           And the court concluded that even if Aimster  
23 could show substantial non-infringing uses, it would have  
24 to show that it would have been disproportionately costly  
25 for it to eliminate or at least reduce the infringing

1 uses.

2 And my time is about up, so I'm going to skip  
3 past the next slide and just mention the most recent  
4 case, which is the Grockster case, where the Ninth  
5 Circuit came up with a different approach.

6 Grockster, as you heard yesterday, again, is  
7 decentralized. The people who sell and make the software  
8 don't know specifically what files are being exchanged.  
9 They don't have a centralized index.

10 The Ninth Circuit, following Sony, said that if  
11 substantial non-infringing use was shown, the copyright  
12 owner would have to show that the defendant had  
13 reasonable knowledge of specific infringement files --  
14 infringing files -- something that the plaintiffs  
15 couldn't do in Grockster.

16 And the Court found there were substantial  
17 non-infringing uses. I don't have time to go into the  
18 one use the court focused on. Maybe in the discussion we  
19 can talk about it.

20 And the court found it irrelevant that the vast  
21 majority of uses of this software were in fact  
22 infringing. It not only disagreed with the Aimster  
23 balancing approach, saying that you have to have specific  
24 knowledge of the infringement at the time at which you  
25 contribute to the infringement, which the court found in

1 that case meant at the time you actually provided the  
2 software to the user.

3 I'll just mention then, very quickly, to get to  
4 the end, obviously we know the court granted cert last  
5 Friday.

6 The one other issue that has arisen in the past  
7 year, the Inducing Infringement of Copyrights Act  
8 introduced in the Senate by Senators Frist, Daschle,  
9 Hatch, and Leahy. The original text of the legislation  
10 would have made one liable for copyright infringement if  
11 one intentionally induced copyright infringement.

12 You see the definition in front of you from the  
13 original bill -- intention, the aiding, abetting,  
14 inducing, or procuring infringement, intent to be shown  
15 by acts from which a reasonable person would find intent  
16 to induce infringement based on all the relevant  
17 information reasonably available to that person,  
18 including whether the activity relied on infringement for  
19 its commercial viability.

20 There was a lot of criticism of the bill as  
21 introduced, particularly from folks in the technology  
22 industries. The Senators who introduced it asked the  
23 Register of Copyright to take a look at the situation,  
24 to talk with parties and see if she could come up with  
25 another approach.

1           We did come up with an approach in September,  
2           which looked at it more from a business model approach,  
3           suggesting that what you ought to look at is ultimately  
4           how this product is used. Don't focus on the technology.  
5           Don't even focus on the state of mind. Just look at what  
6           the facts are, in fact, with respect to how a product or  
7           service is used. And if you offer a product or service  
8           that in fact is a cause of people engaging in infringing  
9           public dissemination, not just personal copying in the  
10          home, but actual transmission to other people, then if  
11          you rely on that infringing public dissemination for your  
12          commercial viability, or if you derive a predominant  
13          portion of your revenues from infringing public  
14          dissemination, or if you principally rely on infringing  
15          public dissemination to attract individuals to your  
16          product or service, then you ought to be held liable.

17                 Well, a lot of folks didn't like that, either.  
18          As you probably all know, after considerable discussion  
19          thereafter, the clock ran out on this legislation and it  
20          simply wasn't possible for all the parties who needed to  
21          come to some kind of consensus to come to that consensus.

22                 It's questionable whether they ever could, but  
23          perhaps the grant of cert might focus people's minds on  
24          whether there might be some way to agree on this before  
25          the court tells everyone what the answer is going to be.



1                   We'll find out.

2                   (Applause.)

3                   MR. DELACOURT: Well, thank you for that,  
4 David. Our next panelist is Stan Besen. Stan is a Ph.D.  
5 economist and a vice president with Charles River  
6 Associates. He is a nationally recognized expert in the  
7 economics of intellectual property rights,  
8 telecommunications policy, and computer standards.

9                   Stan will endeavor to supplement the legal  
10 framework that David has just described by giving us some  
11 background on the economic framework in which P-to-P file  
12 swapping systems operate. Stan?

13                   MR. BESEN: Thank you. My talk is actually  
14 replete with caveats and qualifications, starting with  
15 the very first slide. So this is only the simple  
16 economics of P-to-P networks, and, also, only some of  
17 them. But I will endeavor to make the most use as I can  
18 of the next eight minutes.

19                   I am an economist, so I thought I would start  
20 with a theorem, which I think helps to organize people's  
21 thinking about the subject.

22                   Consider the following case. Suppose that  
23 copies and originals are perfect substitutes for all  
24 users. That is, no one would pay anymore -- in choosing  
25 between them, the only thing that counts is the price.

1 And if the cost of the copy is lower than the cost of an  
2 original, you copy.

3 Second, assume that the marginal cost of a  
4 copying, importantly, including the cost of finding an  
5 original copy is constant. That is essentially you can  
6 make an unlimited number of copies from any original  
7 indefinitely without any increase in the additional cost  
8 to making a copy.

9 And finally, assume that copying cannot be  
10 prevented by either legal or technological means. That  
11 the engineering fixes, as many lures as you can throw at  
12 the problem, you can't stop copiers.

13 Well, what does the theorem say; it says an  
14 equilibrium the price of an original will equal the  
15 marginal cost of a copy. This is bad for copyright  
16 owners.

17 If you want to think about this, you can think  
18 about what gives the copyright owner might think of as  
19 his edge, are two things. One, the fact that he can  
20 provide something that is better than copies. That's  
21 number one.

22 Or, second, something that is in fact less  
23 costly than a copy. If you take away the edge, you take  
24 away his margin. Okay?

25 Well, what do we know about P-to-P networks? I

1 don't know a lot about them. I know a few things about  
2 them. One is they permit copies that are increasingly  
3 close substitutes for originals.

4 Second, they permit an increasingly large  
5 number of copies to be made in the same original without  
6 a significant increase in marginal cost. We've talked  
7 about the great number of copies that get made.

8 In other words, the assumptions in the theorem  
9 are increasingly being met. But nonetheless, the price  
10 of an original has not, and in some of the qualification  
11 has not yet, question mark, declined to the marginal cost  
12 of a copy.

13 Now, I just thought I might give you sort of a  
14 -- think about this problem in sort of numerical terms.  
15 I think the following numerical example is sort of  
16 helpful. It helps me think about this problem.

17 And this is not a substitute, by the way, for  
18 the dueling econometrics that you're going to hear in the  
19 next session. This is just a kind of -- a sort of simple  
20 calculation that might actually help you think about the  
21 issue.

22 According to RIAA statistics, annual U.S. unit  
23 CD sales declined by about 200 million between 2000 and  
24 2003. I actually picked those for a high number and a  
25 low number to make this number big.

1           I am going to assume that the entire decline  
2 was due to illegal downloading. Now, it's possible, of  
3 course, some downloading -- that that's an overstatement.  
4 And conceivably, in principle, could be an understatement  
5 if in fact CD sales would have grown even further above  
6 the 2000 level by 2003.

7           Let's just take that as a number. Assume that  
8 800 million tracks are downloaded in the U.S. each week.  
9 That's a number that I -- I'm really not sure where I got  
10 it. I've seen bigger numbers. Numbers as big as 1.6  
11 million -- billion. I have seen number -- I think Fred  
12 von Lohmann on his paper had 2.5 billion.

13           Let's take 800 million. This implies that  
14 there is about a .005 reduction in unit sales for every  
15 downloaded track -- i.e., it takes about 200 downloaded  
16 tracks to reduce CD sales by one unit.

17           Again, this is not a behavioral analysis. This  
18 is just a calculation to get some idea of the  
19 relationship between the amount of downloading that  
20 occurs and the change in sales that's occurred. No  
21 attempt to draw any sort of stronger inferences than  
22 that.

23           Why hasn't the effect been larger? Well, you  
24 probably all have your own list. I sort of came up with  
25 a list, but feel free to think about other things that

1 might explain why there is this big disparity between the  
2 amount of downloading and the decline in sales.

3 The first, and most obvious, is that many  
4 downloads are copies that would not have been purchased  
5 as originals. I'll come back at the end and point out  
6 that even if that were true, even if that was an  
7 important explanation, that doesn't mean that copyright  
8 owners are unaffected by the downloading. But that's a  
9 sort of first possibility.

10 Second, original and copies are not perfect  
11 substitutes. I understand that some people insist on the  
12 higher quality of CDs, as compared to MP3 files. That  
13 disparity might change, but one factor might be simply  
14 people want better sound quality and a way to pay for it.

15 Sometimes originals are sometimes hard to find.  
16 If you have arcane taste in music, it may actually be  
17 difficult to find somebody who actually has on his drive  
18 something that you actually want to copy.

19 Spoofing has raised the cost of copying. You  
20 heard about spoofing yesterday. Users are concerned  
21 about importing adware, spyware, et cetera. There's all  
22 this extra stuff that comes along with it, and that may  
23 be a sufficient deterrent to some people.

24 Some people are honest. Some people think it's  
25 dishonest to copy or to download. Some people fear legal

1 liability, and some people are not very good at copying.  
2 I think of it as the phobia.

3 The one question -- I think the question that  
4 you ought to think about is, how are these things likely  
5 to change over time? Will the numbers that I have in the  
6 previous chart change, and in what way might you expect  
7 they would change?

8 You might think of two things -- and I can't go  
9 through all of these in the time that's available -- but  
10 think of two things that were actually described at the  
11 first session yesterday. It was suggested that system  
12 operators could in fact increasingly be able to detect  
13 corrupted files. So to the extent that they can do that,  
14 the fact that spoofing has raised the cost of copying,  
15 that could in fact become less important.

16 On the other hand, we were told that cease and  
17 desist orders are pretty effective in discouraging people  
18 from copying. And if so, in fact, if that's really true,  
19 that in fact the situation might get better for copyright  
20 owners.

21 But I think we haven't yet seen the full effect  
22 of the technology. There are a variety of factors that  
23 affect its impact on sales by copyright owners, and  
24 nobody really knows for certain how the trends in these  
25 factors as they change over time are likely to affect

1 copyright owners in the future.

2 A final observation -- I think I am going to  
3 finish within my time. It's the advantage of growing up  
4 in New York and learning to speak really fast.

5 Even if we had good estimates of the effects of  
6 downloading on unit sales, we may understate its effect  
7 on copyright owners. This is separate and apart from the  
8 fact that I'm sure in the next session one of the  
9 questions will be whether we're actually observing the  
10 endgame.

11 So it may well be that one of the reasons -- we  
12 may not be able to get very good estimates of the  
13 ultimate effect on unit sales using contemporary data.  
14 But quite apart from that, there at least seems to be two  
15 reasons why you might expect that even with good  
16 estimates of the impact on unit sales, that in fact you  
17 may understate the effect on copyright owners.

18 The first, of course, is that downloading may  
19 affect the price of originals. And the first, if you go  
20 back to the first theorem, the copyright owners  
21 conceivably could just lower their price just below the  
22 marginal cost of making a new copy. They could maintain  
23 all their sales. They might even increase sales. Unit  
24 sales might even decline, or might even increase, but the  
25 price would go down.

1           So looking at unit sales alone is not  
2 sufficient to determine the effect on copyright owners.

3           The second is the fact that the principal  
4 effect of illegal downloading may be on legitimate  
5 downloading services rather than on the sales of the  
6 physical product. I suggested earlier that conceivably,  
7 probably likely, many of the downloaded tracks, music  
8 tracks, do not represent displaced sales of originals.  
9 Sales of CDs.

10           They could, however, represent displaced sales  
11 of legal downloads, iTunes and the like. If that is the  
12 case, then looking at unit sales, again, will be -- will  
13 give you an incomplete picture of the effect of  
14 downloading on copyright owners.

15           I'm going to stop here. Thank you.

16           (Applause.)

17           MR. DELACOURT: All right. Stan, thank you for  
18 those remarks.

19           Our next panelist is Mark Bohannon. Mark is  
20 the general counsel and senior vice president of public  
21 policy for the Software and Information Industry  
22 Association.

23           Prior to joining SIIA, he was a senior official  
24 at the U.S. Department of Commerce, where he served as  
25 Chief Counsel for Technology, and also as counselor to



1 the Under Secretary.

2 Mark will describe some of the problems that  
3 have arisen with the current legal framework for  
4 addressing copyright in the P-to-P context.

5 MR. BOHANNON: And John, if it's okay, since I  
6 am Power Point handicapped, I'll just speak from my seat  
7 if that's okay.

8 MR. DELACOURT: That would be great.

9 MR. BOHANNON: Good. First of all, it's always  
10 a pleasure to be here at the Federal Trade Commission.  
11 We once again appreciate the opportunity to share our  
12 views. I always enjoy being in the FTC workshops because  
13 unlike so many other fora, which tend to be very rigid  
14 and formal, I have found that every FTC workshop I have  
15 ever participated in is never a dull moment. And I think  
16 this workshop has proved itself -- though I have to say  
17 that we have yet to reach the heights of the canned Spam  
18 workshop, where there were virtual fisticuffs between  
19 Commissioner Swindle and members of the audience, but  
20 it's only 9:38, the morning is still young. So stay  
21 tuned.

22 I am pleased to be here to provide the  
23 perspective of the Software and Information Industry  
24 Association on the issue of file dissemination and  
25 peer-to-peer networks.

1           Just by way of background, and hopefully it  
2 will help inform the perspective I am bringing, we are  
3 the principal and largest trade association of software  
4 code and content companies that produce for a variety of  
5 markets ranging from business, education, consumers and  
6 the Internet.

7           Our membership includes software companies,  
8 eBusinesses, information service companies, as well as  
9 electronic commerce companies.

10           Our membership consists of some of what I like  
11 to call the largest and oldest technology enterprises in  
12 the world, and some of the smallest and newer companies.  
13 They are united in their need to make sure that their  
14 content and software is protected from theft, and they  
15 are also at the leading edge of developing new products  
16 and services and business model for distribution through  
17 innovative channels that reach their customers and users  
18 in ways that they need.

19           We also bring to this perspective the fact that  
20 we have been, and remain a pioneer in combatting theft of  
21 intellectual property over the Internet. And we were  
22 actually the first trade association that began focusing,  
23 many years ago, on the challenge of combatting digital  
24 piracy over the Internet.

25           And let me just say that since we began that

1 effort, we have seen nothing but growing challenges in  
2 trying to deal with that enormous problem.

3 The focus of this panel, of course, is on file  
4 dissemination via peer-to-peer networks. And like David,  
5 I avoid trying to use the word file-sharing. I think  
6 language is important.

7 I think sharing suggests a too benign, a too  
8 passive, a too friendly approach here. I think we really  
9 are talking in terms of legitimate and non-legitimate  
10 activities. About means of distribution and  
11 transmission. I think it's very important to keep that  
12 in mind.

13 So while I may from time-to-time say file-  
14 sharing, I think it's important to talk about what it is,  
15 which is about how we disseminate content and software  
16 across the Internet to a variety of users.

17 There are two things to keep in mind. That in  
18 our industry the issue of file dissemination is neither  
19 new to our industry, nor is it unique to peer-to-peer  
20 networks. And for those of you who are even older than I  
21 am, you will know that dissemination in our industry  
22 started with FTP sites, and continued to message board  
23 chat rooms in a variety of means.

24 Looking ahead to the future, there are  
25 companies who will, and have, made the decision they will

1 no longer disseminate software through optical disks, and  
2 they are entirely relying on the Internet and other kinds  
3 of means.

4 So it's important to understand that file  
5 dissemination is essential issue in our industry, even  
6 outside the context of peer-to-peer.

7 Likewise, we see peer-to-peer networks and  
8 peer-to-peer services as enabling a variety of  
9 activities. Many of which we believe are legitimate.  
10 And it's important that policy makers not lose sight of  
11 this, and I appreciate Commissioner Harbour's comments  
12 this morning in that regard.

13 We are seeing, even as we deal with the problem  
14 of theft through peer-to-peer networks, that peer-to-peer  
15 is becoming an increasingly accepted tool for business  
16 enterprises. We are seeing in some sectors efforts like  
17 financial services to use peer-to-peer in very creative  
18 ways to get their job done.

19 And we are also legitimate content  
20 distribution, legitimate content management occurring.  
21 It's occurring in a variety of ways. I think it's  
22 initial steps that we are seeing. I don't want to over  
23 state it, but I think it's important to understand that  
24 we are starting to see how peer-to-peer can be a viable  
25 way of disseminating legitimate content in ways the

1 consumers want.

2 Those range from everything from interactive  
3 games, where there are some very good examples in the  
4 press and some companies who are trying to make that  
5 work. To areas such as security and anti-virus.

6 We have some member companies in the education  
7 market who are actually doing some very innovative things  
8 about distributing, for example, model curricula.

9 Again, all of these efforts to try to take  
10 advantage of the opportunity and the mechanism and the  
11 means. And having said that, what we are finding are  
12 issues of scalability, security and trust, and even some  
13 standardization issues, particularly for digital content,  
14 that are starting to arise in terms of making that viable  
15 peer-to-peer approach more viable.

16 But the issue of file dissemination through  
17 peer-to-peer, I think, is something that is significant  
18 and differs from both the old style of file  
19 dissemination, and the broader issues of peer-to-peer.  
20 And it impacts our industry I think in three very  
21 specific ways.

22 First, while certainly the focus of press and  
23 most attention is on file dissemination of recording and  
24 audio visual. We are seeing the level of pirated  
25 software in digital that occurs through peer-to-peer

1 growing tremendously.

2 In terms of the volume, we have a variety of  
3 numbers, but let me just draw on a presentation yesterday  
4 in the opening session by Mark Ishikawa with ATSP, who we  
5 have found to be a reliable and consistent measurer of  
6 what is going on here.

7 He indicated that their study showed that on  
8 any given day there are three to 5 million infringements  
9 that are occurring. Our working with Mark, we believe  
10 that about -- while certainly most of that is recording  
11 and motion picture, we believe that about 15 to 25  
12 percent of that is in fact software, which include a  
13 variety of other applications and other kinds of  
14 software, including games.

15 Which means that on any given day you are  
16 probably having in the range of about a million  
17 infringements occurring based on those numbers.

18 The second impact on our industry is that the  
19 products that are often available through peer-to-peer  
20 file dissemination pose risk to consumers and end users.  
21 And we heard a great deal about that yesterday.

22 I want to focus here not on the issue of the  
23 peer-to-peer software, which I think was a very good  
24 discussion about where that's going; but in fact on the  
25 problems of actually the products you get from the file

1 dissemination from peer-to-peer products. Which are not  
2 legitimate copies, and in many cases do pose risks to  
3 consumers.

4 We also are seeing an impact on our industry by  
5 the fact that peer-to-peer file dissemination services  
6 are closely aligned, and in many cases draw their revenue  
7 from adware and other kinds of things that affect  
8 consumers as they browse the Internet.

9 And those relationships do affect, in fact, our  
10 industry. They put great demands on the technical  
11 services of our industry, and I call to your attention I  
12 think the tremendous of the Center For Democracy and  
13 Technology in outlining some of those problems.

14 The third specific impact is, as David pointed  
15 out, that as this environment is growing, we are, and  
16 have seen, court decision that have left a very concrete  
17 hole in the application of copyright law.

18 That leaves copyright holders without effective  
19 legal resources to stopping infringements for  
20 peer-to-peer file dissemination of pirated software and  
21 content is occurring particularly in a decentralized  
22 manner.

23 The result is that there are some real risks,  
24 and the cost to software and digital content publishers  
25 is real and we believe hampers the development of

1 legitimate business that enable distribution over  
2 peer-to-peer networks.

3 The economics here -- and I think it's  
4 important to keep in mind, and, Stan, I think gave a  
5 useful outline. It's important to understand the  
6 economics of the motion picture, recording, and software  
7 are very different.

8 And let me give you one example about why this  
9 is true. The average software company -- and, here, I  
10 say average, because in fact we do see quite a few  
11 companies that, you know, dominate the space. Involves a  
12 company that has three products, one of which accounts  
13 for 60 percent of their revenue.

14 The impact of a company's one major product  
15 being pirated, particularly through peer-to-peer, can  
16 have a tremendous impact. Not just on, as Stan said, the  
17 actual price of an end product, but on the overall  
18 economics.

19 Others on the panel here are going to have some  
20 specific legislative proposals. Let me just I think  
21 highlight -- and I'm not quite sure how much time I have  
22 left. Thank you. That will give me enough time.

23 To highlight I think a couple of things that  
24 the FTC can and should focus on appropriate with their  
25 mission, and I think with their background. The first is



1 be willing to recognize, as we have done before, the  
2 importance of the FTC's initiatives to educate consumers  
3 in spyware. And we want to commend them for having  
4 brought the case against Seismic Entertainment.

5 I thought they were very thoughtful in bringing  
6 that case. They recognized there need to be an analysis  
7 of what potential benefits of the technology there are to  
8 consumers, but we think that that is an important role  
9 given what is the close association between adware,  
10 spyware and some of the peer-to-peer networks that is  
11 occurring.

12 Secondly, we talked about the privacy issues,  
13 and we think that there are -- there needs to be more  
14 information gathered by the FTC in this area. I think it  
15 was a useful discussion yesterday to talk about the  
16 developments, but I think the FTC does have a role in  
17 gathering more data about what are in fact the privacy  
18 implications for peer-to-peer networks.

19 And finally, education. I know that's an easy  
20 thing to say, but I think the FTC is trusted as a source  
21 of information not only by state and local consumer  
22 authorities about these impacts, but also by consumers.  
23 And we believe that the FTC needs to be very explicit  
24 about raising consumer awareness about the implications  
25 of illicit dissemination. About the effects on the user

1 downloaded spyware, and that, finally, that it's not the  
2 real thing that you're often getting from peer-to-peer  
3 networks.

4 But we also urge that the FTC recognize that  
5 this is a very dynamic technological business environment  
6 in which peer-to-peer applications are emerging and  
7 business models are evolving. And just as is done in  
8 other areas, I think the FTC needs to make sure it is  
9 aware of the pitfalls and the opportunities that are  
10 present as it proceeds with any of these initiatives.

11 Thank you, again, for the time, and I  
12 appreciate any questions you may have.

13 (Applause.)

14 MR. DELACOURT: Thanks, Mark. Our next  
15 panelist is Andy Moss. Andy is the Director of Worldwide  
16 Technical Policy at Microsoft. In that capacity, he is  
17 responsible for shaping the company's strategy with  
18 respect to such issues as intellectual property and  
19 content protection, digital broadcasting and broad band.

20 Andy will describe an element by element  
21 approach to the P-to-P file swapping issue as one  
22 potential approach to possible solutions.

23 MR. MOSS: I guess I wouldn't be Microsoft if I  
24 didn't do a Power Point. I don't want to disappoint.

25 Unlike most of the other panelists, I am an

1 engineer and not a lawyer or a trade association. And  
2 what I would like to do is step back a little bit from  
3 some of the legal discussion and provide some context  
4 around the technology that is being discussed, and  
5 perhaps put out some basic principles to help understand  
6 how, at least we, regard some of decision making around  
7 how we view the impact on consumers, the impact on the  
8 market, and how we have tried to evolve some of our  
9 technology.

10           You know, there is good news and bad news in  
11 this. One is that, you know, the convergence that we in  
12 the tech industries are talking about for 10 years or  
13 more, you know, the good news is it's actually finally  
14 happening.

15           You have a lot of merging of interests,  
16 consumer technologies and industries. So you have the IT  
17 sector merging with the CD sector. You have broadcasting  
18 and cable and content communities all wrestling with how  
19 to deal with the fact that dissemination of information  
20 is changing.

21           The value propositions are changing from  
22 economies of scale and high value focused efforts, to out  
23 to the consumer and out to the edge and giving people  
24 more of an opportunity to control their own destiny with  
25 technologies like peer-to-peer.

1           The technology itself is actually not new.  
2       While it's been popular now for the last three or four or  
3       five years, the reality is that it's just a form of  
4       distributive computing that's been around for 20 or 25  
5       years. And there's nothing new about it.

6           What's new is the convergence that took place.  
7       There was the rapid adoption of Internet. There was the  
8       rapid increase in storage capacity. There is the rapid  
9       increase of processing power. There is the compression  
10      algorithms for video and audio that happened in a  
11      relatively short period of time.

12          It all came together that allowed this thing  
13      called peer-to-peer to somehow become very popular. And  
14      what happened was, consumers got hold of the technology  
15      that had largely been in the hands of IT departments that  
16      allowed computers to talk to each other for a long period  
17      of time.

18          So if you think about it, distributive  
19      computing is actually used for everything from AIDS  
20      research, to the search for extraterrestrial life in very  
21      interesting and creative ways.

22          And so peer-to-peer is just one form of that.  
23      The technology is not new, and it's also not going away.  
24      And so all of the discussions that we have around future  
25      policy or potential laws and changes need to be guided

1 with the fact that, you know, there is nothing new here  
2 other than the pace of innovation is continuing to  
3 accelerate.

4 And so we need to be guided a little bit on  
5 some basic principles, which hopefully I'll get to in a  
6 couple of minutes.

7 And so, unfortunately, the technology has been  
8 hijacked. And so, in the popular press, and one of the  
9 more predominant uses, has been some illicit uses for a  
10 very useful technology.

11 There are benefits to technology -- to the  
12 technology, not only beyond, you know, each research in  
13 distributive computing, but allowing rapid discovery of  
14 social computing that allows people to perhaps distribute  
15 media in more effective ways. Because the cost of making  
16 a copy is significantly less because of the bits. If you  
17 can build a business around that, then potentially the  
18 economics are there as well.

19 And that's one of the things that we're looking  
20 for people to explore a little bit more of.

21 We're somewhat of a unique company, and I  
22 understand we were the topic of conversation yesterday.  
23 I am glad I wasn't here for it.

24 We have an interesting relationship to the  
25 technology. We are an infrastructure provider. We

1 provide -- I'm a software guy, not a hardware.

2 (Laughter.)

3 MR. MOSS: So we provide a lot of the low level  
4 infrastructure in terms of protocols. We provide the  
5 operating system, we build applications. And we are a  
6 content creator. Our software is content. We run  
7 services that are content oriented in terms of MSN.

8 We are also a provider of some of the tools and  
9 technologies that can be used to help facilitate some of  
10 the potential benefits, and to help curtail some of the  
11 misuses of the technology.

12 One of the more popular ones that gets a lot of  
13 press is digital rights management. And the trying to  
14 keep in mind here, is that technology is just a tool. It  
15 is no more or no less than whatever people want it to be.

16 I go back to the example of the automobile that  
17 was mentioned in the opening. An automobile can be used  
18 to speed people away from the scene of an accident to get  
19 them to a hospital relatively quickly. It can also be  
20 used to speed away from the scene of a crime.

21 The automobile is neither good nor bad. It was  
22 just being used as a tool to speed people somewhere. And  
23 it's the use of it that is either good or bad. And so we  
24 have to keep that in mind as we think about technology  
25 and how to take advantage of its potential.

1           We are all struggling with the convergence that  
2 I talked about. We wrestle with it, how we deliver new  
3 products. Other industries are wrestling with the human  
4 nature of change. I mean everyone grapples with change.

5           What happened when the automobile was  
6 introduced; what happened to the buggy manufacturers?  
7 Did they become parts manufacturers to the automobile  
8 companies, or did they go out of business?

9           Transformation and technological change causes  
10 people to adapt. If you adapt successfully, you go on.  
11 If you don't adapt successfully, you find something else  
12 to do.

13           And that's really what's happening now, is you  
14 have lots of people who are trying to figure out how to  
15 adapt and what to do with the technology and what the  
16 future holds for them. And change is going to happen.

17           And so the way that we think about how to guide  
18 our actions and what we have been trying to talk to, lots  
19 of communities, whether they're the consumers or the  
20 media industry, or distribution outlets and content, are  
21 -- there are basically four pillars. None of which is  
22 more prominent than the other. They all have to be  
23 addressed equally to advance the benefits that we all  
24 want, and to curtail the misuses that have been taking  
25 place.

1           Technology is one of those pillars. Like I  
2           said, like all technology, it's just a tool. You can use  
3           it for whatever purpose you want. It's a piece of  
4           distributed computing. It's not just file-sharing. It  
5           is a broad range of technologies that have common  
6           elements that enable multiple good things to happen.

7           Lots of people use Instant Messaging. It's a  
8           set of protocols that underline that that also are used  
9           in common peer-to-peer systems.

10          Voiceover IP is an up-and-coming technology, or  
11          set of technologies. It's not an application. It's  
12          actually a set of protocols. Many of which are common to  
13          building peer-to-peer applications.

14          And so we have to think about how all of these  
15          things are reacting. And I'm getting the high sign, so  
16          I'll speak a little faster, as well. I'm also from New  
17          York.

18          The other thing that's important, is in  
19          addition to the technology, we have to make the content  
20          available. Today, the majority of content that's  
21          available has been done for illicit purposes.

22          What we would like to see is the creators of  
23          content taking more advantage of the availability of  
24          making their content available in the ways that they  
25          choose, as a way to offset the volume of piracy.



1           So if the volume of legitimate content grows to  
2 the point where it's greater than the volume of  
3 illegitimate content, then we can have a legitimate  
4 conversation with consumers about alternatives.

5           Last slide. Law and enforcement certainly  
6 plays a part. We're all -- any commercial, capital  
7 society has to have laws that govern it, and it's not  
8 just copyright law. It's all forms of law for  
9 enforcement around respecting property, but also, you  
10 know, all of the issues around consumer awareness and  
11 consumer protection.

12           One of the things that's happening that people  
13 are really grappling with I think that doesn't get enough  
14 attention, is that as we move further and further into  
15 this digital transition and the information age and  
16 whatever other buzz phrase you want to put on it; it's  
17 intellectual property is becoming more and more prominent  
18 in everything we do.

19           As more automobiles being designed, you know,  
20 the designs are intellectual property. Bio-engineering  
21 is intellectual property. Movies and music and software  
22 are all intellectual property.

23           And one of the things that government and  
24 industry, us included, needs to do more of, is make sure  
25 that people and consumers understand the importance of

1 even their own intellectual property.

2 Digital photos and home videos are people's  
3 personal intellectual property that they might want to  
4 think about how to use. How to control the use of. They  
5 may not want those photos to get into hands of strangers  
6 and people they don't know.

7 Content and service providers must promote when  
8 they make their contents legally and legitimately  
9 available. Consumers need to understand the bargain that  
10 they're undertaking. What are the rights that they are  
11 acquiring. Is it free for one use, is it free forever;  
12 am I buying it for \$5 for a month, for a day, for a year.

13 You know, there has to be information conveyed  
14 to the consumer so that they know what they're getting,  
15 when they're getting, and they understand how to use it  
16 and respect it. If they don't know what the rights are,  
17 they don't know how to respect it appropriately. And so  
18 there is an obligation on all of us to participate in  
19 making sure that education of consumers is advanced.

20 And so those are the four basic principles that  
21 govern our actions, and I hope that helps shed some light  
22 for everyone.

23 Thank you for your time.

24 (Applause.)

25 MR. DELACOURT: Okay. Thank you, Andy. Our

1 next panelist is Dean Garfield. Dean is the vice  
2 president and director of legal affairs, worldwide anti-  
3 piracy, for the Motion Picture Association of America.

4 Prior to joining the MPAA, he was vice  
5 president of legal affairs at the Recording Industry  
6 Association of America, where he managed a number of  
7 intellectual property cases, including litigation against  
8 Grockster and Kaza.

9 Dean will discuss the MPAA's position on P-to-P  
10 issues, as well as the development of lawful file  
11 swapping alternatives.

12 MR. GARFIELD: Thanks, Don. Good morning. Let  
13 me begin by dealing with two preliminary issues. First,  
14 I would like to thank the FTC for putting together this  
15 great conference. I would also like to thank the FTC for  
16 inviting the Motion Picture Association of America to  
17 participate in this conference.

18 I promise not to call anyone a polluter, or  
19 associate anyone with the devil.

20 (Laughter.)

21 MR. GARFIELD: I have heard yesterday's  
22 discussion described as CNN meets Jerry Springer. For  
23 those who are hold overs from yesterday who are offended  
24 by what they claim to be loose use of language, please  
25 get in line at the mike now, because I intend to use all

1 of the key terms. Thievery, pirates, and even Microsoft.

2 I plan to quickly cover three issues; where we  
3 are, where I see us going, and how we get there. My  
4 friend Stan Besen started with a theorem, since he's an  
5 economist. I am now part of the movie industry, so I'll  
6 start by asking you to use your imagination.

7 Imagine, if you will, a world in which an  
8 innovative and potentially transformative technology is  
9 introduced into society. Society is immediately improved  
10 in small, but noticeable ways.

11 A group of business people choose to take that  
12 technology and monetize it. Those same business people  
13 hail innovation and technology, but oppose technology and  
14 innovation that would cure the ills occurring on their  
15 system and services.

16 Those businesses seek praise for their  
17 willingness to filter pornography, and employ  
18 sophisticated systems to filter viruses. But claim that  
19 filtering copyrighted content is just not technically  
20 feasible.

21 Those businesses send their users terabytes of  
22 data on a daily basis, but claim that it's impossible to  
23 communicate with their users about copyright  
24 infringement.

25 Those businesses integrate within their

1 networks and systems. Software that monitors detailed  
2 information on their users. But claim that it's  
3 impossible to tell what their users are doing as it  
4 relates to copyright theft.

5 Those businesses regularly update their  
6 software. Sometimes multiple times in a month, but claim  
7 that their software is not malleable, and to suggest any  
8 change to deal with copyright infringement is down right  
9 offensive.

10 Where is this brave new world; is it some  
11 Orwellian world where right is wrong, up is down, night  
12 is day? It is not. It is the world of P-to-P today. It  
13 is a world where transformative technology has been  
14 high-jacked, not by innovators, but by business people  
15 who are motivated by profit and are so blinded by the  
16 chase for money that they fail to see the irony, the  
17 illogic, and incongruity of claiming to be technologists,  
18 while asserting that their hands are tied by  
19 technological limitations.

20 It is a world where innovation is being  
21 retarded by those who leech on those who choose to  
22 create. Technology is simply the platform for their  
23 business gains. Their business is different and distinct  
24 from technology, the technology itself.

25 P-to-P is, P-to-P is, it has been, and will be.

1 It is not new, but it certainly is innovative. The sale  
2 of IBM's PC business is significant in many respects. In  
3 my view, it reflects a move from individualized  
4 collection of data, to network storage where the concept  
5 of the same client will become real, and where  
6 distributive computing and transferring data across vast  
7 networks using peer-to-peer and the concept of  
8 distributive computing will soon be real.

9 To be clear, the Motion Picture Association  
10 fully supports this innovation. Our industry -- for our  
11 industry, where large files rule, distributing computing  
12 will open up new distribution platforms. In fact, the  
13 motion picture studios are already working with  
14 distributed computing concepts.

15 IFilm, which distributes movie trailers and  
16 short films, has been licensed by all of the motion  
17 picture studios, and it is built on a distributed  
18 computing platform from the company RedSlous.

19 Additionally, the motion picture companies are  
20 digitally distributing films through IBeam, CFlicks,  
21 MovieLink, and others. In short, we are working to usher  
22 in a brave new world.

23 The second issue that I would like to address  
24 is the world of tomorrow, which I think is rapidly  
25 approaching, where content is ubiquitously available, but

1 copyright is respected, and real businesses adopt  
2 business rules that allow copyright and content and  
3 innovation to flourish.

4 In my view, 2005 will be a significant year  
5 where many of the concepts that have been rejected by  
6 those whose business is to facilitate piracy, including  
7 incorporating business rules and filtering, will be  
8 adopted by those who are really concerned about  
9 innovation and who want to see P-to-P flourish.

10 P-to-P's businesses that incorporate security  
11 features, such as authentication, digital certificates,  
12 and DRM will flourish. As has been mentioned by some of  
13 the panelists, P-to-P is already being used in many  
14 enterprise settings, and will continue to be used as we  
15 go forward.

16 How do we get to this brave new world that I  
17 just talked about? In my view, it will come from  
18 leadership from agencies like the FTC, who will try to  
19 strike the balance of promoting technology like  
20 distributed computing while making sure that consumers  
21 are protected against bad actors who are motivated solely  
22 by profit and not by concern for technological  
23 development.

24 Second, it will come from supporting filtering  
25 and other business rules that respect copyright and

1 respect innovation. It's important to remember that  
2 technological innovation is just one aspect of  
3 innovation.

4 Working to develop creative works, whether it's  
5 music, film, or software is also an important aspect of  
6 innovation. And that aspect of innovation should not be  
7 lost in the balance.

8 Finally, supporting legal rules that give more  
9 than merely symbolic protection to copyright, but also  
10 protecting innovation in unrelated areas of commerce is  
11 the balance that needs to be struck. And in my view the  
12 Supreme Court will do that.

13 In closing, I would like to simply quote  
14 Senator Gordon Smith from yesterday. If P-to-P file-  
15 trading companies can filter pornography, they can, and  
16 should, filter copyrighted works. Thank you.

17 (Applause.)

18 MR. DELACOURT: Thank you, Dean. Our next  
19 panelist is Bennett Lincoff. Bennett is an attorney,  
20 consultant, and writer living in New York. He previously  
21 served as the director of legal affairs for New Media at  
22 the American Society of Composers, Authors and  
23 Publishers.

24 Bennett will discuss the possibility of  
25 addressing P-to-P file swapping through targeted reforms



1 to copyright law.

2 MR. LINCOFF: Thank you, John. I would like  
3 to also thank the Commission and Commissioner Harbour, in  
4 particular, for organizing this workshop and allowing me  
5 to participate.

6 The Internet is fundamentally incompatible with  
7 the sales based revenue model for works of popular  
8 culture, especially music.

9 Every Internet user, P-to-P network, web  
10 caster, or other digital audio service provider in the  
11 world is a potential source for unauthorized distribution  
12 of recorded music.

13 Through the Internet, the market for sale of  
14 individual recordings can be ruined in a moment's time,  
15 and without payment of any royalties to song writers,  
16 music publishers, recording artists, or record labels.

17 Given this, the sales-based revenue model for  
18 music will soon no longer be sustainable. Neither law,  
19 nor technology, nor moral suasion will change this  
20 result.

21 Unfortunately, instead of transforming itself  
22 to meet these changed circumstances, the industry has  
23 focused only on ways to extend its sales based revenue  
24 model into the digital age. It has experimented with  
25 technological access restrictions and anti-copying

1 measures, pursued legislation to limit the business  
2 opportunities of technology firms, consumer electronics  
3 makers, and web casters; and sued consumers, seeking  
4 ruinous damages for conduct occurring in the privacy of  
5 people's homes.

6           Despite these efforts, the unauthorized  
7 downloading of recorded music continues unabated, and  
8 P-to-P networks proliferate.

9           The industry is now supporting services that  
10 provide partial restricted DRM encumbered P-to-P. But  
11 any licensing scheme that falls short of allowing full,  
12 unfettered DRM free file-sharing, leaves the sales based  
13 revenue model vulnerable to widespread infringement by  
14 consumers who refuse to comply.

15           And even if the industry were to license the  
16 full range of P-to-P capabilities that consumers demand,  
17 so long as its fortunes are tied to the sales based  
18 revenue model, it will have to continue its aggressive  
19 infringement litigation campaign, and its interference in  
20 the free markets for technology, consumer electronics,  
21 and digital audio services.

22           In the meantime, the industry's effort to  
23 salvage its legacy, the business model, has had  
24 collateral consequences. It has slowed the deployment of  
25 high speed broad band connections for the consumer

1 market. Blocked consumer electronics makers from  
2 offering new devices with next generation capabilities.  
3 Limited the growth of web casting and other digital audio  
4 services. Chilled free speech, and interfered with  
5 academic freedom on college campuses. Caused distortions  
6 in music licensing marketplace. Exposed consumers to  
7 liability for enjoying music when, where and how they  
8 want. And by ignoring consumer demand and refusing to  
9 sanction lawful access to full, unfettered DRM free file-  
10 sharing, the industry has relegated consumers to black  
11 market services where adware, spyware, pornography and  
12 privacy violations abound.

13           And for it all, there have been fewer licensed  
14 transmissions of fewer works and fewer royalties than  
15 otherwise may have been earned.

16           I believe that public policy should strongly  
17 support the opportunity of music industry rights holders  
18 to earn ample rewards from their contributions to culture  
19 and commerce.

20           By the same token, however, the industry has no  
21 right to demand that public policy support its desire to  
22 do business in a particular way.

23           An alternative to the sales based revenue model  
24 is needed, and I suggest this. Congress should aggregate  
25 the separate rights of song writers, music publishers,

1 recording artists and record labels in their respective  
2 works and create a single, unified digital transmission  
3 right.

4 This new right would replace the reproduction,  
5 distribution and public performance rights for purposes  
6 of digital transmissions. The right would extend to all  
7 acts that may be implicated in the digital transmission  
8 of music to end users, including, with respect to P-to-P,  
9 downloading works from the networks, as well as offering  
10 them others.

11 The right should be enforceable against all  
12 those involved in the digital transmission of music,  
13 including service providers who offer streaming, those  
14 who offer downloads, P-to-P network operators, and all  
15 P-to-P participants.

16 Under the right, all that would need to be  
17 known was whether or not a work had been transmitted.  
18 Thus, it would no longer matter whether end users only  
19 listened to transmissions, or also downloaded them. How  
20 many copies, if any, were made in the course of the  
21 transmission. Whether transmitted copies were stored on  
22 a temporary or on a permanent basis. Or whether works  
23 are used on one audio playback device, or another.

24 Moreover, the new right would not depend on  
25 access restrictions and anti-copying measures for its

1 success. Nor would it require continued suppression of  
2 the free markets for digital audio services, technology  
3 products and consumer electronics.

4 Rather than limiting access to music, rights  
5 holders would have the incentive to encourage the widest  
6 uses possible. This would free the industry from pursuit  
7 of unhackable technology, allowing it to focus instead on  
8 development of monitoring techniques to support royalty  
9 distribution.

10 And with respect to royalties, they should be  
11 paid on a census of all licensed transmissions, which of  
12 course a digital network would allow. Only through a  
13 census can it be assured that royalties go only to those  
14 rights holders whose works are actually transmitted, and  
15 that all rights holders, large and small, receive that  
16 share of royalty that is precisely proportionate to the  
17 license fees paid for transmissions of their works.

18 The digital transmission right would be bullet  
19 proof against copyright infringement. Unlike the  
20 reproduction and distribution rights as underlie the  
21 sales based revenue model, but like the public  
22 performance right, the digital transmission right cannot  
23 be subverted by one, or even several unlicensed services,  
24 networks, or end users.

25 Whether or not particular transmissions are

1 licensed would not affect the market for a digital  
2 transmission right overall.

3           Moreover, with respect to P-to-P, if the  
4 industry offered what consumers really want, the  
5 overwhelming majority would pay for it. And if that's  
6 not true, then all surely is lost.

7           And the industry, having met consumer demand,  
8 there would be no further justification for public outcry  
9 over the industry's campaign against those who continue  
10 to infringe.

11           The new rights should be subject to a statutory  
12 license. There are millions of copyright and musical  
13 works and recordings, and hundreds of thousands of music  
14 industry rights holders. In a free market, multiple  
15 licenses on inconsistent terms, including possibly  
16 incompatible DRM system, may well be required for each  
17 work transmitted.

18           A statutory license would provide a one-stop  
19 shop guaranteeing all those who qualify access to a  
20 license for all rights and all works transmitted.

21           Such a license would contain non-discriminatory  
22 fees, and provide for centralized payment. It would also  
23 allow for use of standard technology to enable a census  
24 based royalty distribution system.

25           To qualify for the statutory license, one need

1     only comply with music use reporting requirements, and  
2     pay the license fees in a timely manner.

3             And while the statutory license is warranted, a  
4     parallel free market could also operate with rights  
5     holders and anyone needing a license could enter into  
6     voluntary non-exclusive agreements on whatever terms they  
7     find agreeable.

8             A statutory license would enable transmissions  
9     to be made available from the largest number and widest  
10    possible array of competitive licensed services,  
11    including through P-to-P, anytime, anywhere, to anyone  
12    with Internet access.

13            Obviously a fully free market is to be  
14    preferred, but statutory licensing or its equivalent is  
15    already standard practice in the music business. Indeed,  
16    the record business itself is built on the backs of song  
17    writers and music publishers through the compulsory  
18    mechanical license.

19            Given the experience to date, experimentation  
20    with a free market for the digital transmission right  
21    would likely result in continued market failure.

22            Finally, if one looks beyond the interest of  
23    the music industry alone, and considers also those of  
24    technology firms, consumer electronics makers, audio  
25    service providers and consumers, it is clear that a

1 digital transmission right subject to a statutory license  
2 would enhance the free market overall.

3 Change is needed. Congress should induce it.  
4 Thank you.

5 (Applause.)

6 MR. DELACOURT: Thanks for those remarks,  
7 Bennett. Our next presenter is Fred von Lohmann. Fred  
8 is senior staff attorney for Fair Use and Intellectual  
9 Property with the Electronic Frontier Foundation.

10 In that capacity, he has represented numerous  
11 software developers and users against major movie  
12 studios, record labels, and television networks,  
13 including most recently representing streamcast networks  
14 in the MGM v. Grockster case.

15 Fred will discuss the seemingly conflicting  
16 accounts of the impact of P-to-P file swapping on content  
17 providers, and he will also discuss strategies for  
18 addressing file swapping through existing law.

19 MR. LOHMANN: I am a bit tempted to simply say  
20 what Bennett said.

21 (Laughter.)

22 MR. LOHMANN: But you know, perhaps I'll go  
23 ahead and present what I was going to say anyway.

24 I wanted to say a few words about whether or  
25 not in fact the sky is falling, as perhaps many copyright



1 industries would have you believe.

2 And perhaps the more important question of  
3 whether or not the propping up of the sky, should it in  
4 fact start falling, is something that ought to be done by  
5 more laws, more government intervention and more  
6 regulation. Or whether, instead, perhaps there are more  
7 market based solutions.

8 So I think it's good to begin this discussion  
9 with a brief lesson from history. I think history has  
10 quite a bit to tell us about this.

11 And when major copyright industries say that  
12 new technologies to cause their skies to fall, the place  
13 I always begin is with Jack Valenti's famous quote in  
14 response to the VCR, that I say to you that the VCR is to  
15 the American film producer and the American public as the  
16 Boston Strangler is to the woman home alone.

17 A statement that Mr. Valenti, head of the MPAA  
18 at that time, made to Congress in 1982.

19 Of course, as those who pay attention to media  
20 markets, well, no, the VCR turned out to usher in the  
21 single largest new revenue stream the motion picture  
22 industry had ever known.

23 So in fact, history is replete with examples  
24 that echo this lesson. The player piano, broadcast  
25 radio, color television, cable television, the VCR, the

1 audio cassette recorder, digital audio tape; each of  
2 these were new technologies that were greeted by the then  
3 leading copyright industries of the day as technologies  
4 that were sure to bring the sky falling down on the heads  
5 of those businesses.

6 In fact, each and every one of those new  
7 technologies ultimately came to enhance the value of  
8 copyright work.

9 Now, in this discussion I should go back and  
10 emphasize that it's not the case that these technologies  
11 did not disrupt the businesses of the incumbent  
12 industries of the day. They did very much so.

13 The music industry at the turn of the 20th  
14 Century was primarily comprised of sheet music  
15 publishers. Of course the player piano and the recording  
16 technologies that followed essentially made their  
17 business obsolete.

18 That did not, however, mean that copyright  
19 owners were hurt. In fact, the rise of the recording  
20 industry ended up enhancing the value of the creative  
21 works created not just by the song writers, but also by  
22 performers themselves.

23 Each of these technologies was attacked when  
24 introduced; in litigation, in legislation, in public  
25 policy, and public fora of all kinds. In each instance,

1 copyright were in the long run made better off by the  
2 technologies.

3 Of course, history continues to teach us the  
4 same lesson even today. New digital technologies have  
5 been met with exactly the same hostility by incumbent  
6 copyright industries.

7 The MP3 player, the first commercially  
8 available portable MP3 player, was greeted with  
9 litigation by the recording industry.

10 Peer-to-peer file-sharing applications have  
11 also been attacked, as everyone well knows. The personal  
12 video recorders, perhaps epitomized by TVO, have also  
13 found themselves subject to litigation.

14 Replay TV, one of the leading companies, was  
15 forced into bankruptcy by litigation from the motion  
16 picture studios and other entertainment industries.

17 And most recently, just last week, an  
18 innovative company called Kaleidescape, that had the  
19 nerve to try to provide the consumer the same kind of  
20 juke box feature that Apple, with their iTunes had  
21 provided for music, this company intends to provide that  
22 for DVDs, allowing you to put all of the DVDs that you  
23 own onto hard drives that will allow you to do  
24 interesting things, to watch it all over your house, to  
25 access it without having to shuffle optical disks about;

1 they were just sued by the DVD CCA on the theory that no  
2 one should ever be entitled to copy a DVD for any reason,  
3 without permission of course.

4 So in looking at whether the sky is falling,  
5 let's move from history to what we know today. I will  
6 begin by saying that there is no clear complete picture  
7 at this point. The data is yet very new, but the data  
8 that we have suggests at least some trends.

9 So let me start, as this is all information  
10 that you have already seen yesterday. Main stream  
11 peer-to-peer is now five years old. Napster having sort  
12 of launched that revolution. There are at least 20  
13 million users of peer-to-peer file-sharing applications  
14 today. Probably quite a bit more, 20 million is the  
15 lowest I have seen. The other numbers range as high as  
16 60 million, a number that exceeds the number of Americans  
17 that voted for President Bush just last month.

18 There are more than 2 billion downloads every  
19 month. On that number, I guess I agree with the earlier  
20 800 million a week, for roughly the same range. That, of  
21 course, dwarfs the so-called authorized music service  
22 downloads that we have seen thus far.

23 And yet despite the proliferation and continued  
24 success of peer-to-peer file-sharing networks and the  
25 obvious consumer demand for them, you see that this year,

1 CD sales are in fact up.

2 The first three quarters of this year, Sony  
3 music declared to European anti-trust regulators last  
4 year in trying to clear their merger with BMG, that they  
5 were profitable this year.

6 BMG, in fact, declared in that same proceeding  
7 that they had their most profitable quarters in corporate  
8 history in the end of 2003 and beginning of 2004.

9 Investment analysts looking at these trends  
10 have said, in fact, the music industry is more healthy  
11 today, at least in part because they have finally done  
12 the kind of belt tightening and downsizing that has been  
13 long over due for their industry.

14 The economists, just a few weeks ago, published  
15 a story in which the following quote appeared. According  
16 to an internal study done by one of the majors, referring  
17 to the major record labels, between 2/3 and 3/4 of the  
18 reports of the drop in sales in America had nothing to do  
19 with Internet piracy. This, again, a study commissioned  
20 by the major label itself.

21 So what is going on? Well, I think the music  
22 industry is facing a lot of pressures from a lot of  
23 quarter. So you have today obviously there was a  
24 recession, an economic down turn.

25 The music industry is quick to point out that

1 in prior down turns, they did not suffer. And so this  
2 somehow must indicate that they are recession proof  
3 business.

4 Of course, if you look historically, at the  
5 times when there were recessions in the past, the music  
6 industry was fortunate to have had a new format on path  
7 that got consumers to buy all of the same music one more  
8 time. Whether it be the audio cassettes, or the CD.

9 Unfortunately for them, perhaps a sign of their  
10 flagging innovation skills, they don't have that benefit  
11 this time. And so that perhaps they are not entirely  
12 recession proof. Something that has very little to do  
13 with peer-to-peer file-sharing.

14 The Internet, DVDs, and video games are  
15 competing for consumer time and money. The Wal-  
16 Martification, as I put it, of music retailing is a big  
17 problem. They are finding themselves with fewer retail  
18 options and more price pressure. Radio consolidation is  
19 exacerbating that trend. At the same time, the music  
20 industry is reducing the number of new releases they put  
21 out every year by as much as 20 percent, and, in fact,  
22 during the early part of the peer-to-peer revolution, the  
23 music industry responded by raising CD prices. A 10  
24 percent increase between '99 and 2003. Perhaps exactly  
25 the wrong response.

1                   Now, other interesting facts. In Canada, as  
2 some of you may know, there was a very prominent court  
3 decision that held that both downloading and uploading on  
4 peer-to-peer file-sharing networks is legal under  
5 Canadian law. Six months after that widely published  
6 ruling and widely publicized, CD sales in Canada are up  
7 12.4 percent. Furthermore, the losses -- any prior  
8 losses that the music industry in Canada has suffered  
9 have been more than made up for in increases in the  
10 personal copying levies they have there. Similar  
11 experience in Australia. In 1999 -- between 1998 and  
12 2003, during the peer-to-peer revolution, we see a  
13 dramatic increase in CD sales.

14                   All of this suggests that there is more going  
15 on than the simple math that every download is a lost  
16 sale. Music publishers have the same story. The  
17 artists, as you have heard, have a very mixed feeling  
18 about what's going on in file-sharing. This is a quote  
19 from the Pugh studies that came out just last week. The  
20 movie industry, of course, has nothing to complain about.  
21 They continue to have record revenues, record box office,  
22 record home video sales.

23                   And so I would, again, say that here we don't  
24 have a situation of evident failure of copyright law.  
25 Incentives continue to be adequate to create new works.

1           So I just want to very quickly sum up here,  
2 well, what should the FTC be looking at. Well, I don't  
3 think the answer is more laws, more lawyers, more  
4 lawsuits. This is not a more law problem. Instead, we  
5 have a situation where the copyright industries have to  
6 adapt, come up with new business models. Early  
7 indications are that they are, and they may well be  
8 succeeding.

9           You have new authorized music service offerings  
10 that are beginning to offer consumers at least a mild  
11 facsimile of what they have been demanding for years. I  
12 am hoping that maybe additional development there will be  
13 helpful.

14           But if that doesn't work, I actually would like  
15 to end where Mr. Lincoff ended, by saying what we should  
16 be looking for is perhaps some collective licensing  
17 solutions. I am in some ways more optimistic than he is.  
18 I don't think copyright law needs to be changed. I think  
19 the laws will accommodate the creation of new collecting  
20 societies that can offer the kind of blanket licenses  
21 that Mr. Lincoff mentioned without the need for any  
22 copyright law reform.

23           And if the FTC would like to do something  
24 productive, I think it should look into what barriers may  
25 exist in the current music industry marketplace that are



1 interfering with the creation of those collecting society  
2 approaches. Approaches that most industry insiders and  
3 economists agree would probably be more efficient, better  
4 for innovation, and, in the end, actually generate higher  
5 revenues for the very industries that are today most  
6 concerned about peer-to-peer file-sharing. Thank you.

7 (Applause.)

8 MR. DELACOURT: Okay. Thanks for those  
9 remarks, Fred. Our last panelist will be Peter Menell.  
10 Peter is a professor of law at the University of  
11 California/Berkeley School of Law, and executive director  
12 of the Berkeley Center for Law and Technology.

13 He has written extensively in the area of  
14 intellectual property law, with particular focus on legal  
15 protections for computer software.

16 So Peter is going to give us -- take a more  
17 global approach, and help us make sense of what we have  
18 heard so far this morning by describing a framework for  
19 understanding and analyzing the various policy proposals  
20 that have been set forth so far.

21 MR. MENELL: Good morning, everyone. It's a  
22 real honor to be part of this distinguished panel, and I  
23 can see -- well, I guess there is some static on the  
24 panel that I was picking up.

25 (Laughter.)

1           MR. MENELL: Well, my presentation today tries  
2 to provide a framework for moving from rhetoric and  
3 advocacy towards at least a somewhat neutral -- I realize  
4 neutral is a hard word to use in Washington. But my goal  
5 is to really try to provide a systematic framework so  
6 that we can compare and contrast different approaches.

7           I do think that we are at a critical stage in  
8 the evolution of two of the most important industries in  
9 our history. It's really a historic period when you  
10 think about the history of copyright law.

11           Copyright law has always been implicitly about  
12 platforms, technology platforms. Copyright didn't exist  
13 until there was technology for distributing works of  
14 authorship. And we are now at, I think, probably the  
15 most important transition in the history of this law.

16           So let me try to put this into the broader  
17 historical perspective, and I'll go back to 1440, which  
18 is roughly the time that the Gutenberg printing press  
19 came about. And I think that there is a very important -  
20 - and I think along the lines that Fred suggested,  
21 symbiotic relationship that has existed between the  
22 contents and technology sectors.

23           I realize that there has been tension, but by  
24 and large things have worked out in a way that has been  
25 generally productive for both sets of industries.

1 Notwithstanding the loss of some jobs in particular  
2 sectors. Player piano performers lost business when the  
3 talkies came about.

4 And you can find examples like that, but by and  
5 large it's a very strong systematic I think symbiotic  
6 relationship.

7 Why? Well, almost all of the technologies over  
8 this period discouraged unauthorized distribution. One  
9 of the greatest forms of encryption ever invented was  
10 called vinyl. Vinyl did not allow for others to make low  
11 cost, high quality copies of works of authorship.

12 The film industry had a great form of  
13 encryption. They didn't release their products to the  
14 market. They rented them to theaters for distribution.  
15 It was a very good market. It was a secure market.

16 Those entities in our society that distributed  
17 works of authorship were highly regulated. Regulated by  
18 the FCC. And so anyone who was distributing works  
19 without permission on an FCC regulated outlet, was easily  
20 detected and easily brought to justice.

21 And so I think one can sum up this very long  
22 period of history with the conclusion that unauthorized  
23 distribution could be detected at reasonable cost, and it  
24 produced a win-win situation as new formats developed.

25 Okay. Let's look at the last decade or so.

1 The digital revolution. I realize the digital revolution  
2 goes back to the 1940s, but for our purposes it really is  
3 the world wide web. The ability to distribute works  
4 across this vast Internet.

5 And so how has that changed these assumptions  
6 on which the relationship between content and  
7 technologies companies has formed? Well, technology no  
8 longer discourages unauthorized distribution.

9 Once the cat got out of the bag. Once the  
10 recording industry distributed their content in  
11 unencrypted format, basically once the computers became  
12 available for copying, the content was copyable and  
13 distributable at low cost.

14 And we no longer have control over the  
15 distribution outlets. We're no longer talking about FCC  
16 regulated entities, we're talking about ISPs and wireless  
17 on the world wide web.

18 And so we can no longer, and I think it's one  
19 of the clear facts to come out of the last day and a  
20 half, that we no longer can prevent unauthorized  
21 distribution at reasonable cost. It is a costly  
22 enterprise, and we're seeing a lot of resources brought.  
23 And that has created an increasingly conflictual  
24 relationship.

25 So let me just be a little more specific,

1 because it didn't happen all at once, and as Fred has  
2 suggested, alarm bells have gone off periodically.

3 But I do think that there is something to be  
4 said about the Peter and the Wolf allegory here. I think  
5 -- and I am Peter, so --

6 (Laughter.)

7 MR. MENELL: -- it was brought to my mind early  
8 in life. I think Peter eventually gets eaten.

9 (Laughter.)

10 MR. MENELL: So you know, but I realized that  
11 you lose credibility if you keep setting off alarm bells.  
12 I don't like the Jack Valenti quote because I think it  
13 was wrong at the time, and it's clearly wrong  
14 historically. But we can look, I think, at technology  
15 and see some patterns.

16 So let's look at what I will call the three  
17 versions of the Internet, at least for our purposes.

18 So there was the client server model, where  
19 basically ISPs were the way by which everyone gained  
20 access to this great resource.

21 And in this world, users clients could post  
22 works onto web sites. So they would move music files or  
23 other files, and the copyright industry said, as Fred has  
24 reminded us. You know, this is going to destroy our  
25 industry. We cannot survive where people can post files

1 without authorization.

2 But they went out and they hired some folks who  
3 policed the Internet for them, and with the DMCA and  
4 cease and desist letters, they have done a pretty good  
5 job. You see that they can pull down all those music  
6 files on the servers.

7 And so version 1.0 didn't kill the content  
8 industries. I'm willing to say that. Version 2.0,  
9 central server peer-to-peer, Napster, didn't kill the  
10 content industries. Napster, in that form, was found  
11 infringing.

12 Okay. So now we're in version 3.0, the  
13 decentralized model. All of these hundreds of different  
14 peer-to-peer models, and there is a question about  
15 whether existing doctrine will consider these providers  
16 of the software, of the tools, to be infringers. And  
17 that's something I wish the Supreme Court will render a  
18 decision by June.

19 What we are seeing, though, is this new wave of  
20 enforcement. So I would call the present age, at least  
21 for purposes of this hearing, not just the Internet age,  
22 but the Internet and copyright enforcement age.

23 And that poses what I think is the fundamental  
24 choice that society faces in this new world. This brave  
25 new world. And this is a choice I think between three

1 very different views of the role of government.

2           And we are in Washington, and that's what this  
3 is about. I would say that the copyright industries and  
4 the technology industries have co-existed for most of the  
5 last century on a platform which can be called private  
6 enforcement, or perhaps more appropriately, anarchy.  
7 Now, anarchy didn't unfold because private enforcement  
8 tended to work. And as we saw, it was very difficult to  
9 engage in unauthorized distribution.

10           One of the choices that is before Congress is  
11 whether we should ramp up a regulatory role to view this  
12 problem as one to which government, public enforcement,  
13 different forms of regulation should apply.

14           And then a third approach, which was talked  
15 about by Bennett and Fred, is let's just have the  
16 government set the prices. And perhaps the market can  
17 play some role in that.

18           But let's just be clear about what we're  
19 talking about between these three models. In the  
20 regulated market model, we're talking about the notion  
21 that content industries will invest on the basis of what  
22 they think the willingness to pay consumers will be.  
23 That's a traditional structure on which most of our  
24 economy is built.

25           In the anarchy model, we're talking about

1 content industries investing based on their ability to  
2 constrain access to their work. Where they have to  
3 compete with some dark net.

4 And the dark net will always be there, but it's  
5 a question of how many people are going to the dark net  
6 to get their works.

7 And then the third model is content investment  
8 is a function of how much the government is willing to  
9 regulate.

10 So let me try to provide a matrix for thinking  
11 about these issues. And I have tried to just identify  
12 what are the criteria that we would I think ideally want  
13 to include in that matrix.

14 First, is there was the problem that led to  
15 copyright in the first place. We worry that creative  
16 expression might not be produced in sufficient quantity  
17 unless there is some ability to control its distribution.

18 There are up front costs of investment. I  
19 think music is actually the weakest example here, because  
20 the cost of producing the music have gone down quite a  
21 bit over the last several decades, and, you know, I think  
22 the studies are showing that the music industry perhaps  
23 is not vulnerable in the way that it was quite as  
24 predicted.

25 But you can't separate out music from film and



1 software. And these are very expensive products to  
2 develop. The Lord of the Rings trilogy is not something  
3 that my kids would want to see discouraged. And so we  
4 have to think seriously about very substantial up front  
5 costs in these industries.

6 Okay. We also care about competition. We want  
7 competition among content developers. I would like to  
8 see the price of music go down, but I would like to see  
9 it go down because there is lots of entry. There are  
10 lots of indies that want to come in and provide music  
11 cheaper.

12 I also care about competition in innovation for  
13 systems for delivering content. The IPOD was a great  
14 innovation in my household because I didn't let my kids  
15 do what their friends do.

16 But because of the IPOD, they're now cool. But  
17 there was that three-month period where I was not cool.

18 (Laughter.)

19 MR. MENELL: Then I think we have to look --  
20 and I think Fred has been very articulate in a lot of  
21 forums about this, about external effect.

22 And we heard yesterday about the Internet  
23 functionality that could be threatened by a highly  
24 regulatory environment. We also worry, I think, about  
25 product innovations that may be outside of the direct

1 content industries. The chilling effects on all sorts of  
2 consumer products.

3 And then there are the sort of generalized  
4 implementation costs that we deal with in any government  
5 policy making exercise. Some models of government will  
6 bring a lot of lobbyists to Washington. Many of them are  
7 here today.

8 I consider this, as an economist, not  
9 necessarily a good thing. We won't take a vote on it.

10 Another big cost of this system is private  
11 enforcement. It's not a good thing for the record  
12 industry and the film industry have to go to court.  
13 Those are dead weight losses. They're going to have them  
14 in certain policy approaches.

15 And then, last, and I think in some ways the  
16 most important issue, is the dynamic qualities of the  
17 regime you pick. Whatever system you pick needs to last  
18 a long time. We don't want to be back here every five  
19 years.

20 So here are the three models. Now, I don't  
21 think anyone is going to throw tomatoes yet, because, you  
22 know, this is pretty neutral.

23 One of the things that I'll take away from this  
24 panel is that no one agrees as to one sort of fix to all  
25 of this that will satisfy all of the concerns that I have

1 listed. And if we try to just sort of quickly map it  
2 out, and I realize I threw this together late and I don't  
3 want to spend a lot of time discussing it, I just want to  
4 show that no regime is perfect.

5 So I think the anarchy regime works great if  
6 you're trying to promote Internet functionality. But  
7 it's not going to be so good in terms of minimizing  
8 enforcement costs, and it's not going to be too good on  
9 creative expression, at least in some of the industries  
10 where there is high up front costs.

11 If you go to the regulated market, it probably  
12 would help Dean -- and I thought I saw -- there he is.  
13 You know, they would probably like the idea of some  
14 regulated market, a little more control. But let's face  
15 it, that is going to constrain some of our New Yorkers  
16 for fair use, and they're not going to like that.

17 And if we go to compulsory licenses, it's  
18 probably going to provide some money in the pockets of  
19 artists. It's going to substantially reduce enforcement  
20 costs, but it is going to have effects on innovation and  
21 new products, because no one is going to be able to make  
22 profits in some of these markets.

23 So rather than focus on the details, what I  
24 just want to conclude with is there is a heterogeneity of  
25 taste, and technological possibilities that at least in

1 one sense favors using markets. Markets are good when  
2 things are diverse and complicated.

3 The enforcement issues though would seem to  
4 favor some kind of compulsory scheme, because we just cut  
5 that off at the pass. But that's going to impede  
6 innovation.

7 And if we care mostly about the Internet, we're  
8 going to want some kind of non-regulatory approach, but  
9 that's going to lead industry to try to lock up their  
10 products as much as possible.

11 I do want to say as we turn in the next panel  
12 to looking at studies, that there are some dogs that  
13 aren't going to bark here that are very important.

14 And what I will say is that the roll-out of  
15 content is not something that anyone is very good at  
16 measuring. But it may be from a consumer stand point the  
17 biggest issue. The fact that we still rely on  
18 Blockbuster and NetFlicks, and we can't just go to our  
19 broad band and get access is a problem.

20 There are a lot of studies out there. The Pugh  
21 study has been mentioned. The Pugh study is not one that  
22 I feel very comfortable about because it treats every  
23 garage band the same as they treat Don Henley. And from  
24 my standpoint, you know, I'm willing to give Don Henley a  
25 little more voice here.

1                   So you know, I do think you do have to be  
2 careful about how these studies are put together.

3                   Now, perhaps Don Henley didn't want to talk to  
4 these people, but he's still important and his coalition  
5 is one that should be heard from.

6                   As I said, I think the dynamic attributes are  
7 going to be very important. Right now we are forming the  
8 expectations for the next generation of consumers. And I  
9 can tell you from looking at my kids and their cohorts,  
10 we're not doing a very good job of training them to be  
11 good consumers. And that is something that is going to  
12 be very important because it's hard to untrain some of  
13 those values.

14                  And the last thing I'll say, which is pretty  
15 self-evident, is that we're not going to get perfection.  
16 We're never going to get consensus in this room about  
17 what to do, and so we have to look at what the economists  
18 would call second best. Thank you.

19                  (Applause.)

20                  MR. DELACOURT: All right. Well, thank you  
21 very much to all of our presenters. And I see that we  
22 already have a number of folks lining up at the  
23 microphone. So now I would like to take the opportunity  
24 to offer these folks a chance to ask questions.

25                  I would ask that each of them try to keep your

1 questions brief. I ask the panelists as well to try and  
2 keep responses brief given that we only have about 15, 20  
3 minutes here.

4 A PARTICIPANT: Mr. Garfield, your statement  
5 was extremely eloquent, although parts of it were highly  
6 inaccurate. Having said that, I want to focus in on  
7 filtering.

8 MR. GARFIELD: Don't let the facts get in the  
9 way of rhetoric.

10 A PARTICIPANT: We understand the facts  
11 differently, but let me ask about filtering. We're now  
12 hearing from the entertainment industry in general this  
13 simplistic moniker, well, if you can filter this or that,  
14 then certainly it's simple to filter out copyrighted  
15 works.

16 But in fact, the legal policy and technical  
17 issues raised by filtering out the vast world wide body  
18 of copyrighted work really deserve a whole day of  
19 hearings or workshop on their own. Also, the industry's  
20 demand for filtering is very selective. For example, the  
21 record industry, I'm mystified, they never call their  
22 friends in Silicon Valley, like Carley Ferarina or Steve  
23 Johnson and say, Carley, you know that software you  
24 bundle on every computer, that software that burns an  
25 unlimited number of our full audio copies and copyrighted

1 works and surely is displacing sales of software that  
2 creates the MP3 files, which are the basis of our piracy  
3 problem.

4 That software which knows it's facilitating  
5 infringement because it immediately goes after the  
6 compact disk data base, and knows these are our copyright  
7 works. Could you make the trivial, trivial change to  
8 block or at least limit that infringement. That  
9 filtering demand is never made.

10 But here's my question, and it's the same  
11 question I asked --

12 MR. GARFIELD: Knew there was one in there  
13 somewhere.

14 A PARTICIPANT: There is a point. That your  
15 industry is pleased to sue small start-up companies, but  
16 doesn't want to take on big players.

17 My question is, and I asked this of the RIAA  
18 yesterday, and I hope to get a more satisfying answer.  
19 Any effective filtering system I know for copyrighted  
20 works is imperfect and requires centralization because of  
21 the vast data base and the identifying technologies that  
22 must be employed. They can't be bundled with a small  
23 distributed software application. This creates knowledge  
24 and control, knowledge and control is what brought down  
25 Napster I, and Aimster.

1           Is the MPAA -- would the MPAA support the  
2           concept -- but would they support the concept that  
3           peer-to-peer software distributors who implement  
4           imperfect centralized filtering, and that's -- basically  
5           if the law required this would ban decentralized P-to-P,  
6           get a legal safe harbor because it's going to create  
7           knowledge and control, and because it's not going to be a  
8           hundred percent effective?

9           Otherwise, you're asking people to implement a  
10          step which is going to put them out of business because  
11          they're going to be back in prohibited territory based on  
12          U.S. case law?

13          MR. GARFIELD: I think it's a fair question. I  
14          disagree with the underlying assumption, though. I don't  
15          think that filtering requires centralization. And so I  
16          don't think it's necessary.

17          But my view is that --

18          A PARTICIPANT: Can you cite an effective  
19          filtering out for copyrighted works process which doesn't  
20          require a central server? I don't know of one. I'd be  
21          glad to hear of one.

22          MR. GARFIELD: Well, the problem is that most  
23          of the P-to-P services that are out there are filtering  
24          for other purposes using the same methodologies that  
25          would require -- that would apply to filter copyrighted



1 content. But in fact you're not filtering copyrighted  
2 content.

3 For example, Kaza has built into it the  
4 BullGuard virus filtering, which uses the same hash  
5 algorithm that would be required for filtering  
6 copyrighted content. It's just not being implemented.

7 MR. DELACOURT: Okay. Does anybody else on the  
8 panel have a quick comment on this? Otherwise --

9 MR. LOHMANN: Yes.

10 MR. DELACOURT: Fred, go ahead.

11 MR. LOHMANN: No, I just want to -- I think  
12 this entire debate about filtering is an enormous red  
13 herring in this debate. I mean, this is a debate  
14 between, quite frankly, the current MPAA and RIAA  
15 companies and Charmin and other P-to-P companies that  
16 really, in my view, are not really the issue anymore.

17 Right? P-to-P companies is, you know, to some  
18 extent -- you know, it's an interesting point for debate,  
19 but today the leading peer-to-peer application, one of  
20 the leading applications, BitTorrent, there is no  
21 company. It was designed by one person as a hobbyist, an  
22 open source piece of software. He has no company. He  
23 doesn't develop any revenues from it. Anyone can improve  
24 it.

25 In fact, just yesterday, Professor Edward

1 Felton at Princeton's computer science department put out  
2 as a demonstration that you could write a peer-to-peer  
3 file-sharing application in 15 lines of code.

4 And within 24 hours, someone had responded by  
5 improving it such that he wrote the same application in  
6 nine lines of code. All right?

7 This debate about filtering only works in a  
8 world where you have centralized intermediary parties who  
9 you can enforce against. It is, as Peter mentioned, in a  
10 peer-to-peer world, there will no longer be a few  
11 companies that you can enforce against.

12 There will be everyone who knows how to program  
13 a computer will be able to introduce an application which  
14 will not include filtering if consumers don't want it to  
15 include filtering.

16 MR. DELACOURT: Okay.

17 MR. LOHMANN: So that's a problem.

18 MR. DELACOURT: We'll get one more. I know  
19 there's more that you can say on this.

20 MR. GARFIELD: It's on the point. It's on the  
21 point of BitTorrent. I mean --

22 MR. DELACOURT: Okay.

23 MR. GARFIELD: The point is that it's not the  
24 technology. I think the example that Fred gave gives the  
25 answer. There are a number of BitTorrent services that

1 in fact filter out copyrighted content.

2 There are services that are dedicated to  
3 political speech. It's very easy to do if you have the  
4 will to do it.

5 MR. DELACOURT: Okay.

6 MR. GARFIELD: It just so happens that most of  
7 these companies make their money through the lure of  
8 copyrighted content and refuse to do so.

9 MR. MENELL: Okay.

10 MR. GARFIELD: It's that simple.

11 MR. DELACOURT: We'll move on to the next  
12 questioner, and if you please could identify yourself  
13 before asking your question.

14 MR. FISK: My name is Adam Fisk. I used to  
15 work at Limewire for many years, and my question is also  
16 for you, Dean.

17 MR. GARFIELD: Surprise, surprise.

18 MR. FISK: Yes. Yes, I basically just take  
19 issue with the idea that P-to-P companies are all  
20 business and no technology. Or that they are businessmen  
21 and not technologists. And I come from a world where you  
22 have thousands of open source programmers all over the  
23 planet devoting their -- devoting 40 hours a week, in  
24 some cases, to this technology.

25 And many of these people I know personally, and

1 beyond that, you have people like Rom Cohen, who  
2 distribute BitTorrent, that constitutes 35 percent of all  
3 Internet traffic, and he goes about it on his free time.  
4 He -- that's a donated project.

5 So I think that's just a misconception.

6 MR. GARFIELD: I agree with you.

7 MR. FISK: You know --

8 MR. GARFIELD: Let's start with where we agree.  
9 I agree with you.

10 MR. FISK: Okay. And I guess another sort of a  
11 part of that community is the research worlds, where you  
12 have top institutions, like the Stanford Data Bases  
13 group, MIT, Harvard, Carnegie Mellon, all these computer  
14 science departments are investing tremendous resources  
15 into distributed search algorithms, distributed  
16 downloading algorithms that are incorporated by the  
17 P-to-P companies, and where the P-to-P companies are the  
18 primary advancers of that technology.

19 So I think it's just wrong to paint the world  
20 in that light.

21 And I guess my question to you would be even  
22 people like Andrew's colleagues at Microsoft research are  
23 investing a great deal of energy into that area, into  
24 those kinds of algorithms, and, again, those algorithms  
25 are getting incorporated from Microsoft into P-to-P

1 technology and P-to-P companies.

2 So my question to you would be what do you say  
3 to Andrew's colleagues at Microsoft about their work?  
4 Are they wasting their time, are they --

5 MR. GARFIELD: No, absolutely not. I mean, I  
6 think I started by saying imagine -- my little thing  
7 about imagine, if you will.

8 I think the one thing to be clear about is that  
9 P-to-P and distributed computing generally holds powerful  
10 potential for all of us. Particularly for our industry,  
11 where you're distributing large files on a large scale.  
12 It makes a lot of sense to not have a central server  
13 through which all those files are distributed. So I  
14 don't think those people are wasting their time.

15 I think it's important that those who are  
16 building a business plan around the technological  
17 platform come up with rules, business rules, that will  
18 allow innovation to flourish while continuing to preserve  
19 and protect copyright.

20 MR. DELACOURT: Okay. Andy, do you have a  
21 quick comment on that?

22 MR. MOSS: I think I would have to agree. I  
23 mean, you know, the technology will continue to advance,  
24 and I think that there are a number of technologies.  
25 It's not just, you know, the peer-to-peer application

1 level, but it's transport protocols and discovery  
2 protocols and compression algorithms; and all those  
3 things are going to advance.

4 It's a business model issue. People need to  
5 build businesses that support creators' opportunity to --  
6 you know, sell their work. It's all about choice, right?  
7 You create something, you should have the choice of how  
8 it gets distributed.

9 MR. DELACOURT: Okay.

10 MR. MOSS: If you want to give it away, you  
11 should give it away. If you want to sell it, you should  
12 have that opportunity, as well.

13 MR. DELACOURT: All right. Can we move on to  
14 the next questioner, then?

15 MR. MITCHELL: Thank you. John Mitchell, and I  
16 would like to thank the panelists for the quality of the  
17 presentations.

18 I have basically a fundamental disagreement  
19 with the whole approach, however. There has been a lot  
20 of discussion of filtering, but we have only been looking  
21 at one side of the coin. And I think I'll take issue  
22 with -- just not to break the pattern, I'll take issue  
23 with something Dean Garfield said.

24 (Laughter.)

25 MR. MITCHELL: But in a way that I think he

1 will agree.

2 MR. GARFIELD: I didn't think I was being so  
3 controversial, but apparently I was.

4 MR. MITCHELL: I think you will agree that the  
5 statement that peer-to-peer systems can and should filter  
6 out copyrighted works is fundamentally wrong in the sense  
7 that you will agree that if the government mandated that  
8 all peer-to-peer systems had to filter out all  
9 copyrighted works, that law would be challenged and  
10 stricken on First Amendment grounds immediately.  
11 Why? Because there are millions of Americans with  
12 billions of works out there who don't want their works  
13 filtered.

14 And the problem I think we have is not a  
15 filtering out problem, it's a filtering in problem. If  
16 I, today, wanted to set up a peer-to-peer system in which  
17 I only allowed in works for which the copyright owner --  
18 we're talking about copyrighted works -- the copyrighted  
19 owners said, "take my works, please, and reproduce them,  
20 download them, upload them, please," I have no easy way  
21 of doing that.

22 The copyright office system right now is way  
23 behind on technology. There is no data base there where  
24 I can simply go and find out what works are out there  
25 that the copyright owner has already authorized, or, five

1 years into it, decided to authorize to dedicate to the  
2 public domain, or license particular rights, or let me  
3 use it if it's non-commercial.

4 All those kinds of things, we're suppressing,  
5 fundamentally, the freedom of speech of the copyright  
6 owners who do not belong to the Motion Picture  
7 Association or Recording Association's stable of works.

8 And I think the last comment about someone's  
9 slide of a fear of rampant, unauthorized distribution, I  
10 think the real fear was a rampant -- the fear of the  
11 established copyright owners of rampant authorized  
12 distribution, which might finally let consumers have  
13 access to the other 15 percent of independent filmmakers  
14 and artists and so forth who did not have a voice in the  
15 established distribution system.

16 So perhaps starting with data, but could we get  
17 a little reaction to how can government make sure we have  
18 balance here, and facilitate a filtering in of voices  
19 like mine, where I write something and I know nobody is  
20 going to pay me for it, but I'd sure like people to not  
21 feel that they risk a 150,000-dollar fine if they copy  
22 it. Because I want them to copy it.

23 And so that creates a bias, a chill, on my  
24 freedom of speech as a copyright owner when I don't have  
25 a way of explaining to the public by registering with the



1 copyright office and saying "take my work, please."

2 MR. DELACOURT: David, do you have any comment  
3 on that?

4 MR. CARSON: Well, we don't have any position  
5 on filtering as such, but I think whenever I hear people  
6 like Dean talk about filtering, I don't think they're  
7 really saying filter out all copyrighted works.

8 I mean, if you go back to the Napster case and  
9 look at the remedy in that case, the copy owners had an  
10 obligation to let Napster know what works they didn't  
11 want Napster to permit exchange of.

12 And I assume when I hear people talking about  
13 filtering, they're talking about something along that  
14 model. Copyright owners would in some -- one way or  
15 another, let peer-to-peer services know, look, these are  
16 the works of art that you are not authorized to permit  
17 exchange of. And you would have a list, perhaps -- how  
18 you would identify it, I don't know. I'm not a  
19 technologist.

20 But I think it's simplistic, and I think we're  
21 probably talking in shorthand when people like Dean are  
22 saying filter out copyrighted works. I think it's filter  
23 out the works for which copyright owners have decided  
24 they are withholding authorization.

25 But Dean could probably speak more

1       authoritatively than I can on that.

2               MR. GARFIELD:  No, I agree with you, David.

3               MR. DELACOURT:  And Mark, I saw you nodding  
4       your head.  Did you have a comment on that, as well?

5               MR. CARSON:  I mean we're -- our industry is  
6       extremely sensitive to filtering issues.  So I appreciate  
7       where the gentleman is coming from.

8               But I do think we are talking in shorthand.  I  
9       think we are talking about a very different kind of  
10      approach than what is generally assumed.

11              MR. GARFIELD:  The one thing I would add is  
12      that we're not wedded to filtering as the only solution.  
13      I think we're open to various solutions.  We just want  
14      people to work at it.

15              MR. DELACOURT:  Okay.  Peter, did you have  
16      something?

17              MR. CARSON:  I mean the other thing to think  
18      about is one of the things that technology has done is  
19      allowed more people to create.  All right.  It's dropped  
20      the cost of creation dramatically over the last 25 years.

21              So for you as an author or a song writer or  
22      musician, I mean you can set up a relatively inexpensive  
23      music studio today using, you know, off the shelf  
24      technology that's easy and cheap.

25              And you're the first person I ever heard

1 complain about not being able to distribute work. So  
2 that's sort of a new issue, but -- not being able --

3 MR. DELACOURT: Peter had a comment, I believe.  
4 Go ahead.

5 MR. MENELL: Just briefly. One of the reasons  
6 that I am inclined towards market solutions, is because  
7 markets are very good at getting works out. And there  
8 are reasons why the major content industries formed in  
9 the way they did.

10 There were a lot more barriers to developing  
11 the kinds of markets that have supported these  
12 industries. But now we're moving to another platform.  
13 And I think that their clients, their principle clients,  
14 are going to have to sweat a lot more to compete.

15 And we haven't seen sort of the major break-  
16 through artist, but we're starting to see the independent  
17 record business come back to life. The independent film  
18 industry is taking off, and eventually we're going to  
19 move away, in the same way we've moved away from travel  
20 agents for getting airplane tickets. We're going to move  
21 away from brick and mortar distribution models.

22 And the other thing is, I realize this is about  
23 peer-to-peer, but advances in technology are enabling  
24 artists to get their work out without peer-to-peer. You  
25 can actually host a web site and distribute your work

1 without even getting into these issues. And for a  
2 musician, the size of the work is going to be small  
3 enough that you can do that.

4 For a film producer, probably not yet, but  
5 computers are going to make that possible, too.

6 I realize that there are some bigger benefits  
7 from a peer-to-peer network, but there's no question that  
8 markets are going to reshape these industries, and that's  
9 really what we're bracing for right now.

10 MR. DELACOURT: Okay. I think we've got time  
11 for maybe a couple of more questions if they're quick.  
12 Sir?

13 MR. WINECOOP: Okay. Good day, everybody, my  
14 name is Brent Winecoop.

15 Mr. Moss, wonderful presentation, but it leads  
16 me to a particular question. Since you come to us from  
17 the folks out in Washington, I was wondering, since the  
18 FTC, as part of the stated purposes of these hearings,  
19 was looking for ways to protect the American public from  
20 viruses, spyware, and malware, if you could explain, as a  
21 technologist, why it is Microsoft's operating systems  
22 have the problems of being able to be infected with these  
23 things when other operating systems, in particular one  
24 from the University of California/Berkeley called BSD,  
25 are totally immune to these things, whether running

1 peer-to-peer file-sharing applications, or not?

2 It would seem that if this is what the FTC  
3 wants to protect the American public from, we should find  
4 out why the predominantly used product in America allows,  
5 through technological problems, these things to happen?

6 And then I've got a question for Mr. Garfield  
7 after that.

8 (Laughter.)

9 MR. GARFIELD: I thought I was going to get by.  
10 Now I have to say something about Microsoft?

11 (Laughter.)

12 MR. MOSS: I thought I was getting by. You  
13 know, it's a fair question. I think there is a number of  
14 factors, and you have to look at all of them.

15 One is, first of all, I doubt that any  
16 operating -- all operating systems are immune. I think  
17 there is a degree that you have to look at, and they're  
18 all subject -- if you let me continue. That they're all  
19 subject to some degree of issues.

20 Now, part of the answer is we evolved rather  
21 quickly. Just like every other technologies. There is a  
22 high volume. When you look at -- step back, and you  
23 think about the last 20 years, the PC was invented as a  
24 stand-alone, isolated device. It gradually took on  
25 connectivity opportunities and the Internet came, and it

1 rapidly became this mesh of interconnected things.

2 We need to keep pace with that, and, you know,  
3 we're working really hard to catch up to a lot of the  
4 techniques that will help make our operating system a  
5 little bit more secure.

6 That's one aspect of it, and we just have a lot  
7 of work to do, and we're doing it.

8 The other aspect is, PC is an open platform,  
9 and one of the things that has always made it valuable is  
10 that people can put anything they want onto it, and  
11 developers can write any software they want for it.  
12 So you have this interesting dynamic at play where you  
13 need to balance the ability and flexibility of the open  
14 platform and at the same time, make it more secure.

15 And that's a very hard challenge. I don't  
16 think anyone wants us to lock down the operating system  
17 so no one can install new software products. All right?

18 And so if you want anybody to be able to  
19 install a new software product that they write, or they  
20 acquire anywhere in the world from any software  
21 developer, they have to be able to do that. That's the  
22 value of the open PC platform.

23 So you have two dynamics at play here. And so  
24 we're working really hard to try to address that.

25 MR. DELACOURT: Okay. I think, Stan, did you

1 also have a comment on that?

2 MR. BESEN: I think somebody should say  
3 something in response to the collective licensing --  
4 compulsory license proposal here.

5 I can't remember the number of conferences like  
6 this in which somebody has proposed how is compulsory  
7 licensing as a solution to a problem like this one.

8 I think before when moves in that direction  
9 went off to look at the variety of compulsory licensing  
10 systems -- they're all quite clumsy, as Peter has  
11 suggested. They require someone to set the prices. They  
12 require to distribute the boodle among the rights  
13 holders. They don't work all that well.

14 And so, like Peter, I think maybe it's just a  
15 hope at this point, but I, too, hope that the solution  
16 will come from business models so rights holders can  
17 regain their edge, rather than in the first instance  
18 leaping to some sort of government solution to the  
19 problem.

20 A PARTICIPANT: Let me just clarify. I didn't  
21 hear anybody here embrace the sort of old style licensing  
22 approach. In fact, I agree with you. It has a lot of  
23 drawbacks. I do think, however, collective licensing has  
24 proven very successful. You look, and it was  
25 interesting, Mr. Lincoff comes from a background at

1 ASCAP. ASCAP is an entity that does not administer a  
2 compulsory license. ASCAP was not created by government  
3 action. ASCAP's prices are not set by the government.

4 MR. LOHMANN: Actually, that's not quite right.

5 A PARTICIPANT: It is -- it is exactly right.

6 MR. LOHMANN: No --

7 A PARTICIPANT: They are subject to an anti-  
8 trust consent decree.

9 MR. LOHMANN: And they have a rate court.

10 A PARTICIPANT: That is correct, but they --  
11 but the rate court does not set the initial prices.  
12 There is some anti-trust oversight. Something which the  
13 FTC, I think, is somewhat familiar with, but that's a  
14 different matter than a compulsory license where the  
15 government, a priori, sets the prices and handles all of  
16 that from a statutory point of view.

17 There is no need for that. We can have a  
18 collective approach that doesn't require compulsory  
19 licensing and foisting the entire job on the copyright  
20 office, which I know from prior conversations with David,  
21 the copyright office is not eager to be forced into that  
22 position, either.

23 So I think there are intermediate solutions.  
24 Solutions that economists like Professor Mergis, and  
25 others, have said, you know, this may give us the best of



1 both worlds. I agree with Peter, it's still not perfect,  
2 but I do think there is much better here to be  
3 accomplished than the old style compulsory licenses of  
4 yore.

5 MR. DELACOURT: Peter. Oh, go ahead.

6 MR. LOHMANN: I believe that's a factually  
7 inaccurate description of the way that ASCAP rate court  
8 operates, but that would --

9 A PARTICIPANT: Then Peter can tell us.

10 MR. DELACOURT: Okay. Peter, your name has  
11 been taken -- oh, well, if you can do a quick response,  
12 yes.

13 MR. LOHMANN: I'll certainly try to. Actually,  
14 I'm not going to respond specifically to the ASCAP rate  
15 court.

16 MR. DELACOURT: Okay. Sure.

17 MR. LOHMANN: I won't do that. Compulsory  
18 licensing, there is the question of whether the copyright  
19 owner is compelled to license the work, and that's what  
20 compulsory licensing is. The question of how the fee is  
21 going to be set for that compulsory license is really a  
22 separate question. Whether it's done through something  
23 like an ASCAP rate court, or through the new CARP-type  
24 proceeding, or however, both of those processes for  
25 setting rates, both of them, begin with the opportunity

1 for voluntary negotiation between representatives of the  
2 rights owners and the user communities to come to a  
3 voluntary negotiated market place agreement. Under the  
4 oversight, on the one hand, of the rate court, and on the  
5 other hand, of a CARP proceeding.

6 MR. DELACOURT: Okay.

7 MR. LOHMANN: But the compulsory part of it is  
8 that every rights owner has their works compelled to be  
9 licensed.

10 MR. DELACOURT: Okay.

11 MR. LOHMANN: It's separate from the question  
12 of how you set the fee.

13 MR. DELACOURT: Okay. And Peter, your name was  
14 taken in vain, so I'll let you have the last word.

15 Okay. Well, after yesterday's proceedings, I  
16 decided that I would have succeeded in laying out a  
17 framework if I offended everyone in equal measure.

18 So I think this last --

19 A PARTICIPANT: I think that was Dean.

20 MR. MENELL: Oh, okay.

21 (Laughter.)

22 MR. MENELL: No, I think Cary Sherman was quite  
23 persuaded by --

24 MR. DELACOURT: Okay. Well, I think that  
25 brings us to the conclusion.

1 MR. MENELL: Well, I do want to say one thing  
2 on this issue, which is we seem to be experiencing a time  
3 warp here. There is no way in which you can solve the  
4 music problem and not address the film problem.  
5 And there is no compulsory licensing system that anyone  
6 has proposed that deals with the highly heterogenous cost  
7 structure associated with film. And then you've got  
8 software, and when the book reader technology improves,  
9 you're going to have books.

10 And so I do think that we're heading into a can  
11 of worms if we think we can have the government decide  
12 these issues. I think we're going to wind up with the  
13 farm support system that we have for agriculture.

14 (Laughter.)

15 MR. MENELL: I'm serious. I'm serious. That  
16 would be the ultimate result of this, because every year  
17 people would come to Washington, and say, well, how much  
18 should the copyright owners get this year.

19 And it would become so far disconnected from  
20 what consumers in the market value the works at. We  
21 will, I think, wind up with the worst of all worlds. But  
22 you know, I'm open.

23 MR. PAHL: Mr. Delacourt, if I may?

24 MR. DELACOURT: I think we're out of time. I  
25 appreciate everyone participating today. We're going to

1 have a short break now. We'll be reconvening at 11:15.

2 I encourage everybody who did not have a chance  
3 to ask their question to come forward and speak with the  
4 panel as you're on break. Thanks.

5 (A brief recess was taken.)

6 MR. PAHL: Everyone, we're going to turn to our  
7 last panel of the day, which is P-to-P File-Sharing and  
8 Music Distribution. This panel will be moderated by  
9 Hajime Hadeishi, who is an economist in our Bureau of  
10 Economics.

11 MR. HADEISHI: Good morning. The last panel of  
12 this conference is a case study about the music industry.  
13 We're going to talk about the issue of how file-sharing  
14 may or may not impact pre-recorded music sales.

15 In this panel, we have tried to assemble a  
16 diverse panel of experts to discuss the challenges the  
17 music industry is currently facing and how it might  
18 respond.

19 Just so you know in advance, we have a very  
20 tight schedule today, as there is another FTC Commission  
21 event in this hall. We will be wrapping it up at 1:00  
22 promptly.

23 Each panelist will present a 10-minute  
24 uninterrupted speech. We're going to have to be very  
25 strict on the time, again, due to the constraints imposed

1 on us. And the order of presentations will be from my  
2 left, continuing on down, as it is in the agenda.

3 I would like to introduce the panelists. The  
4 first speaker will be Mr. Cary Sherman, the president of  
5 Recording Industry Association of America.

6 Our next speaker, who is accompanied by his  
7 co-author, will be Dr. Koleman Strumpf of the Economics  
8 Department at the University North Carolina, Chapel Hill.  
9 His co-author, Dr. Felix Oberholzer-Gee, is also present,  
10 from the Harvard Business School.

11 We'll then have a presentation from Dr. Stan  
12 Liebowitz, Director for the Center for the Analysis of  
13 Property Rights and Innovation, and Professor of  
14 Managerial Economics at the University of Texas at  
15 Dallas.

16 John Potter will be speaking. He is the  
17 executive director of the Digital Media Association,  
18 which represents groups such as iTunes and RealNetworks,  
19 and others.

20 Les Ottolenghi, President of INTENT Media  
21 Works, and a member of the P-to-P Revenue Engine. We'll  
22 be talking about his interesting new business model.

23 Followed by Sam Yagan, who is president of  
24 EDonkey, and Wood Newton, who is a songwriter, from the  
25 National Songwriter's Association International. I think

1 he'll be singing.

2 (Laughter.)

3 MR. HADEISHI: And Mr. Newton's well-known  
4 songs are Bobby Sue, performed by the Oak Ridge Boys;  
5 Riding With Private Malone, performed by David Ball;  
6 Twenty Years Ago, performed by Kenny Rogers; and What I  
7 Didn't Do, by Steve Warner and also recorded by George  
8 Jones.

9 As a plug, his new album, Bubba is in Baghdad,  
10 is going to mainstream radio this week. So we look  
11 forward to hearing it. And as my wife makes me listen to  
12 WMZQ, I'm sure I'll be hearing it soon.

13 And then the last to speak will be Michael  
14 Bracy, co-founder and policy director of the Future of  
15 Music Coalition.

16 Thank you. Mr. Sherman.

17 MR. SHERMAN: Thanks very much, Haj. Good  
18 morning. I certainly would like to thank the FTC for  
19 organizing this workshop and inviting us to speak.

20 I just want to give you a quick perspective of  
21 the recording industry on everything you've been hearing  
22 about today.

23 We've got to differentiate P-to-P as a  
24 technology from P-to-P when it's an opportunistic  
25 business model. As to the technology, we're all for it.

1 It's an important technology.

2 It holds great promise for everybody, including  
3 our industry, but that promise has been diminished by  
4 those P-to-P operators who have built business based on  
5 the systematic and wholesale theft of others' copyrighted  
6 works. That is simply wrong, and the consequences have  
7 been devastating, I guess.

8 You have all heard the data by now. Since the  
9 end of 1999, when file-sharing first came onto the scene,  
10 to the end of 2003, which is the last year of complete  
11 data, total units shipped fell 31 percent, while the  
12 total value of those shipments fell 18 percent.

13 We don't have figures for 2004 yet, but  
14 preliminary indications would suggest a modest  
15 improvement.

16 From 1999, to today, the industry's all  
17 important top 10 albums shipped over 40 percent less.  
18 And the importance of that, of course, is because that's  
19 where the industry makes most of its money, from the  
20 major sellers. That's what enables them to offset the  
21 losses.

22 But let's not forget the personal toll when you  
23 just look at these numbers, and I know we're going to  
24 hear a lot about numbers from the other panelists.

25 The fact is, that while illicit file-sharing

1 services seek to offer their users a veil of anonymity,  
2 and you have to wonder why they emphasize that so much.  
3 The effects are hardly a secret.

4           The impact of illegal file-sharing has been  
5 felt by tens of thousands of artists, songwriters, retail  
6 clerks, plant workers, and other music industry employees  
7 who have lost their jobs, substantial portions of their  
8 income and their opportunities.

9           Across the country, retail record stores have  
10 fired employees and closed shop, unable to compete with  
11 the millions of people who are purveying the same  
12 products on-line.

13           The story of MusicLand, that was a chain of  
14 mall-based record stores, was purchased by Best Buy in  
15 2001, for \$685 million. It was sold last year for 1.

16           At least a thousand record stores have been  
17 forced to close in the last three years, including many  
18 of the shops that were landmarks in small towns and on  
19 college campuses around the country.

20           Record companies and others in music business  
21 have been faced with mass lay-offs, and so many people  
22 work behind the scenes in the music industry that it may  
23 be easy to think that file-sharing is a victimless crime,  
24 but in fact the practice has devastated the industry and  
25 harmed countless people along the way.



1           But the workers aren't the only victims. It's  
2 inevitable that consumers are going to lose out too. And  
3 interestingly, the FTC came to that very conclusion about  
4 15 years ago on the issue of cable decoder boxes.

5           Chairman Daniel Oliver commented at that time,  
6 "widespread or unchecked free riding could discourage  
7 venturers that would offer such services, or could result  
8 in raising the prices for cable subscriptions in existing  
9 networks beyond optimal levels."

10           And those findings are equally relevant to the  
11 proliferation of services offering illegal file-sharing.  
12 Those services could, in Chairman Oliver's words, not  
13 only result in present injury, but could also undermine  
14 the competitive process that encourages innovation or  
15 maintenance of such facilities, and thereby the risks of  
16 collateral consumer injury.

17           In the end, it's truly the consumers who are  
18 going to pay the price here.

19           Unfortunately, record companies see this impact  
20 all too clearly, because we're the ones who are putting  
21 our money at risk. And it's important to understand what  
22 record companies do here. They are venture capital  
23 firms. We make investments that no bank would consider.  
24 We invest in people. We invest in talent, and the hope  
25 and the dreams of aspiring musicians, and we spend

1 resources, both financial and human, to nurture the  
2 talent and try to create the demand in the marketplace  
3 that permits those artists and their music to thrive.

4 We don't do that knowing full well that nine  
5 out of ten times, we're not going to make it. That nine  
6 out of ten of those artists will never return the  
7 investment that was made in them.

8 So it's an extremely risky venture, and our  
9 reward for the effort is sharing the financial success  
10 when the tenth artist does thrive. And that system has  
11 helped to create and sustain the most vibrant music  
12 community in the world.

13 Rampant on-line piracy has thrown a monkey  
14 wrench into that system. Consumers who used to be able  
15 to vote for the favorite music with their pocketbooks now  
16 don't have to vote with money at all. They can get the  
17 same music for free. So as a result, illegal file-  
18 sharing has undermined the very foundation of the music  
19 marketplace.

20 Using Peter Menell's analogy about anarchy, it  
21 really has created a riot, and there has been mass  
22 looting. A look at the most illicit P-to-P systems shows  
23 that the works most requested are the most popular albums  
24 from the most popular artists. These are the very  
25 artists, the one out of ten, who support the rest of the

1 industry and allow investment to take place.

2 So the result is inevitable; lower returns  
3 means less ability to invest in the market. Fewer new  
4 artists, fewer new products, fewer choices for consumers.

5 Fortunately, the industry has not simply  
6 allowed that unhappy turn of events to slow down the  
7 transition to new technologies. It's clear that  
8 consumers are very interested in getting their music  
9 digitally. The common mantra that we always hear, that  
10 the music industry has to embrace technology in the  
11 future by adopting a new business model, well, the fact  
12 is that the industry has been doing just that.

13 The recent and rapid increase of legitimate  
14 on-line distribution services has been made possible by  
15 very aggressive licensing efforts by record companies and  
16 other copyright holders. And by the way, this is a very  
17 complicated industry in terms of rights structures. So  
18 it isn't just record companies who have to license.  
19 There are music publishers and songwriters. There are  
20 the artists, who often have contractual rights to control  
21 electronic distribution on-line.

22 So it is difficult to get everybody to agree on  
23 a common business model and move forward, but I think we  
24 have finally seen a lot of success on that.

25 One of the industry's most ambitious

1 initiatives has been to work with the higher education  
2 community. We filed a report with Congress in October,  
3 from the Joint Committee of the Higher Education and  
4 Entertainment Communities, in which we demonstrated that  
5 the groups have been working together to reach out to  
6 colleges and universities across the country to engage  
7 students in discussions on P-to-P and copyright, and to  
8 find new ways to bring content to those consumers.

9 The good news is that we now have about 36  
10 different schools that have signed up to provide a means  
11 for students to get a wide range of entertainment content  
12 legally and easily, and we hope that number will grow as  
13 students continue to embrace these legal services.

14 There are now, in fact, a plethora of sites on  
15 the Internet where consumers can get quality, legitimate  
16 product. Services such as iTunes, MusicMatch, and the  
17 now legitimate Napster offer clearly legal product free  
18 of viruses, spyware, adware, corrupt content, as well as  
19 good connections. No free riding on users' band width or  
20 processing power.

21 You also have notices and labeling that remain  
22 intact. So consumers and parents can make informed  
23 decisions about whether the content is appropriate for  
24 them. And legitimate services provide an infrastructure  
25 to ensure that creators, producers, providers, and the

1 thousands of individuals who work hard to bring consumers  
2 the products they enjoy, get paid.

3 Illicit P-to-P services offer none of those  
4 benefits.

5 The growing avenues for distribution of  
6 legitimate content, or for a broad range of ways to enjoy  
7 that content, includes subscription and on demand  
8 services, as well as services that offer the download of  
9 files, both by individual song and by album as the  
10 consumer prefers.

11 The different methods and qualities of  
12 distribution are made possible by the availability of  
13 different price points. Streaming services cost less  
14 than tethered or limited time downloads, which cost less  
15 than permanent downloads that are transferable to CDs.

16 The problem is that free trumps everything.  
17 And those services that offer copyrighted material for  
18 free are directly jeopardizing continued development and  
19 the survival of these new legitimate services which are  
20 focused on the very needs and desires of consumers.

21 For the first half of 2004, there were 58  
22 million single tracks legally downloaded or burned from  
23 licensed on-line music services. But that figure is  
24 dwarfed by the extraordinary number of downloads  
25 estimated to be made illegally in 2004, and I hesitate to

1 even suggest what that number is, because I don't think  
2 anybody really knows.

3 So even though those services are gaining  
4 ground, the continued progress is directly impeded by the  
5 unauthorized offering of identical products for free by  
6 P-to-P services.

7 The companies that offer P-to-P services derive  
8 their revenue primarily from advertising. That revenue  
9 stream is dependent upon a significant and consistent  
10 number of visitors to the file-sharing network. Those  
11 visits are ensured by a wealth of free files made up  
12 predominantly of unauthorized copyrighted material.

13 So the incentive for these services to remain  
14 illicit is clear. Under their current business model  
15 their very viability depends on it, and that was sort of  
16 confirmed by Michael Weiss, chief of StreamCast Networks  
17 who distributes Morpheus, who said in an interview, users  
18 are likely to abandon any file-sharing network that  
19 restricts their downloading in favor of the many networks  
20 that don't. We have a race to the bottom here.

21 Such views and business models do need P-to-P  
22 technology. Did you say time is up? Oh, okay. Sorry.

23 Well, that's --

24 (Laughter.)

25 MR. SHERMAN: We certainly hope that it won't

1 doom P-to-P technology for the future to a dismal future.  
2 Our industry has been trying to work with responsible  
3 technology companies to find ways to legitimize P-to-P  
4 and succeed where the illicit services have failed.

5 We have partnerships with companies like  
6 SnowCap and World Media that are looking now for ways to  
7 harness the power of the technology without relying on  
8 injury to the rest of the industry to turn a profit.

9 And you know, we've already talked a lot about  
10 filtering and how it can be used for porn and everything  
11 else, and viruses, we certainly think it can be used for  
12 copyrighted works as well.

13 The problem is that there are lot of  
14 short-sighted players on the P-to-P side. In the words  
15 of Wayne Roso, the problem is that even though the  
16 opportunities are starting to arise now and the record  
17 companies are reaching out, many colleagues are backing  
18 off -- afraid that if they play ball, they'll lose their  
19 traffic.

20 So what's happening is that the music industry  
21 is embracing the challenge to adapt its business model,  
22 but illicit P-to-P services are threatened by the  
23 prospect of changing theirs.

24 I just want to mention briefly that there is a  
25 case going on in Australia that I think people should

1 watch. It's a case against Charmin Networks by the major  
2 record companies down there, and the evidence that's  
3 coming out in that has been very interesting. It has  
4 become clear that services like Kaza not only have the  
5 ability to monitor the network activity of users, but  
6 also to implement filtering technology.

7 The CTO of Charmin acknowledged the existence  
8 of a secret Judas version of the Kaza software that  
9 gathered user statistics and sent them to a central  
10 server. Such revelations are pretty eye-opening,  
11 especially in light of the claims that they simply don't  
12 know what their users are doing and have no control over  
13 the content they share. The truth is coming out now in  
14 court.

15 The clear message, P-to-P is an exciting and  
16 promising technology. It's been savaged by bad actors so  
17 far. The focus belongs not on the technology itself, but  
18 on the unscrupulous services that abuse it to the  
19 ultimate detriment of consumers and others. The question  
20 is whether we'll embrace this technology in such a way as  
21 to benefit everyone or let it be permanently high-jacked  
22 for the short-sighted gain of a few.

23 We are ready and willing to work with the --  
24 anybody who distributes music in any form, including  
25 P-to-P, as long as it recognizes, respects, and enforces



1 the rights of copyright holders and the value of their  
2 works. We want consumers to have confidence in a robust,  
3 safe, and legitimate on-line experience. Record  
4 companies are now doing that. We expect nothing less of  
5 the companies that provide P-to-P technology and the  
6 exciting possibilities it offers.

7 Thanks very much.

8 (Applause.)

9 MR. HADEISHI: Our next speaker will be Koleman  
10 Strumpf, who is presenting a rather remarkable result.

11 MR. STRUMPF: Okay. Thanks, Haj. I,  
12 hopefully, will try to convince you by the end of this  
13 talk that the results are not quite so remarkable.

14 This is going to be largely framed around some  
15 research that I have conducted with my co-author, Felix  
16 Oberholzer, who is sitting also on the panel. So the big  
17 picture about what I'll be talking about is what's file-  
18 sharing do. Well, one thing we've heard quite a bit  
19 about over the last two days is that file-sharing seems  
20 to reduce some of the controls the copyright owners have  
21 over their property. And there has been a lot of policy  
22 discussion both here, and particularly in Congress, that  
23 we might need to reform laws, provide new powers to  
24 copyright owners to offset some of this.

25 And I think what's the sort of fundamental

1 question in answering whether this is an appropriate  
2 policy, is what is the actual economic damage from file-  
3 sharing. And the sort of smoking gun that Cary just  
4 talked about, and I'm sure you read quite a bit about in  
5 the newspaper, is the following. Okay?

6           Since 1998, album shipments, according to the  
7 record industry, have fallen by 20 percent. In 1999 --  
8 that's when the free file-sharing service, Napster, first  
9 became popular, so most people say, well, this is  
10 obviously a smoking gun -- in fact, I am going to try to  
11 give you two intuitive arguments, or two sort of broad  
12 arguments first about why I don't think that's actually  
13 true, and then I'll sort of drill down and give you some  
14 more specific evidence about this.

15           The first point is it's not actually completely  
16 obvious intuitively that this is a correct -- there's a  
17 link between file-sharing, or negative link between file-  
18 sharing, and record sales.

19           First of all, file-sharing allows people to  
20 learn about music that they wouldn't have otherwise  
21 learned about through browsing other people's directories  
22 or things like that, which might, in the end, lead to new  
23 purchases.

24           But probably more importantly is the fact that  
25 file-sharing is disproportionately as an activity

1 attracted to people who are not likely to have been  
2 purchasing albums anyway. In particular, people who have  
3 a lot of time on their hands, and not a lot of money.

4 But let me -- you know, even though I'll talk  
5 later on about why I'm not such a big fan of looking at  
6 aggregate data; let me give you three pieces of  
7 information that are not at all consistent with this  
8 notion that file-sharing hurts record sales. Okay.

9 The first piece of information is that while  
10 Napster, as I pointed out, was created in 1999, record  
11 sales actually continued to go up according to Sound  
12 Scan, and 2000, and so far this year they're up.

13 The second piece of information is that people  
14 download lots of things besides music on file-sharing  
15 networks. In particular, they download things like video  
16 games, and they continue to sell quite well. It's hard  
17 to understand how that could be true.

18 The third piece of evidence is the following.  
19 It's something that an economist might call something  
20 like an experiment. It's the idea that over the summer,  
21 currently, students disappear. College students leave  
22 campus, okay?

23 Well, when they leave campus, they leave that  
24 really nice high speed connection that they have, and if  
25 the story is true that file-sharing hurts record sales,

1 we should expect that sales of albums during the summer  
2 shouldn't go down quite as much as they go down  
3 throughout the rest of the year because file-sharing goes  
4 down.

5 In fact, BigChampagne, for example, documents  
6 that file-sharing does decrease by about 15 percent  
7 during the summer.

8 Well, in fact, what happens to sales during the  
9 summer months? In fact, sales during the summer months  
10 haven't changed almost at all since file-sharing was  
11 created.

12 So just I'll try to -- bear with me with this  
13 graph for two seconds. This graph shows you weekly sales  
14 for 1998, and 2003. So the blue line shows sales in  
15 1998, the red line shows you sales in 2003.

16 The blue shaded area is the summer. In fact,  
17 you can see, according to this graph, that sales during  
18 the summer are actually lower in the period when file-  
19 sharing had been in creation. The exact opposite of what  
20 you'd think.

21 Now, I don't really want to talk a lot about  
22 what other people have done in terms of evidence on file-  
23 sharing, except for just one sort of broad point. Again,  
24 this comes back to what I just talked about. It  
25 basically frames a lot, for example, what the record

1 industry has said. And that's looking at time series  
2 correlations.

3 So much of the evidence about file-sharing and  
4 record sales explicitly says, well, we see that file-  
5 sharing goes up and sales go down. There must be a link  
6 between the two.

7 But in fact, time series evidence really can  
8 only be useful in terms of ruling out factors. In other  
9 words, it's very difficult when we look at, for example,  
10 two trends that go together to say that one is causing  
11 the other.

12 And the main reason is there are lots -- you  
13 have to consider every other factor that possibly could  
14 be out there.

15 In other words, I can't think of any way, using  
16 time series analysis, that I couldn't argue against the  
17 fact that the reason the record industry is in trouble is  
18 that Brittany Spears is no longer a teenager.

19 So again, there's lots of other evidence, which  
20 I'll be glad to talk about with folks later, but because  
21 of time constraints, I won't dwell on so much.

22 So let me tell you more specifically about what  
23 the research that Felix and I have undertaken. Now, I  
24 think the only way, if you want to understand an  
25 activity, to really learn or understand about it, is to

1 actually focus on what's going on.

2 And so we are the -- we, Felix and I, in our  
3 research, were the first to look at what people were  
4 actually downloading on file-sharing networks. In  
5 particular, we have access to a very large data base of  
6 downloads. Almost 2 million downloads during the end of  
7 2002.

8 And so we take the -- the basic idea is we  
9 tried to take the argument on face value that file-  
10 sharing hurts record sales. And so in particular, the  
11 claim would be that albums that are downloaded more  
12 intensively should see a greater reduction in sales.

13 Now, there is a very important kind of  
14 conceptual issue that I don't want to dwell a lot on.  
15 And again, I'll be glad to talk to anybody about this  
16 afterwards. But it's important to at least briefly  
17 mention here. And that's if you want to do this kind of  
18 analysis, it's important to take note of the fact that  
19 there is a common factor that drives both sales and  
20 downloads -- namely, the popularity of an artist.

21 In other words, somebody like Eminem, who sells  
22 a lot of albums, is also very popular in file-sharing  
23 networks. That doesn't mean there's necessarily a causal  
24 relation between one and the other.

25 And so what Felix and I do is a very standard

1 approach in economics, and it dates back 30 or 40 years.  
2 Is to look at factors that shift downloads, but don't  
3 necessarily have a direct effect on sales to try to get,  
4 tease out, this kind of causal relationship between  
5 downloads and sales.

6 So let me just give you one example of the kind  
7 of thing that we looked at. It turns out there's quite a  
8 bit of variation in the spelling of song titles on  
9 albums. In particular, one very common thing is not to  
10 use standard English in titling songs.

11 Now this might seem pretty innocuous to most of  
12 you, but think about how file-sharing works. Somebody  
13 supplies a file, which they name in some fashion, and  
14 somebody searches out the file using some kind of search  
15 engine.

16 If either the searcher or the sharer of the  
17 file changes the spelling, or spells things in a  
18 different way, they're not going to find a match.

19 So it turns out empirically in the real world  
20 that songs that have misspellings in them tend to be  
21 downloaded less frequently. This is exactly the sort of  
22 thing that we need. Something that's going to shift  
23 around downloads, but, of course, as you probably might  
24 surmise, there is very little effect of whether song  
25 titles are spelled using standard English on record

1 sales.

2 So what is it that -- what are some of the  
3 results that we found in our analysis? Well, there's  
4 sort of two main sets of results.

5 The first main sets of results are, well, what  
6 is it that people actually download, or what's being  
7 downloaded on file-sharing networks? It turns out what's  
8 basically being downloaded is stuff that you hear on the  
9 radio. In particular, stuff that's on the top 40.

10 But probably just as interesting, people don't  
11 download whole albums. They really only download one or  
12 two songs per album.

13 Well, why is this important? Well, this is  
14 important because it suggests in and of itself that we  
15 might not expect to see a lot of crowd out between file-  
16 sharing and record sales.

17 Well, why is that? If you're a file -- if  
18 file-sharing users are the sorts of people who are only  
19 interested in two songs on an album, those are not likely  
20 to be the people who are going to pony up \$18 to buy the  
21 CD.

22 In fact, somewhat, you know, additionally  
23 consistent kind of evidence with this is if you look at  
24 paid services, paid download services like iTunes seem to  
25 have a different kind of individual where people download



1 whole albums.

2           So what's the big picture about what we found?  
3 Well, I'll state it two different ways. The main  
4 conclusion is that there really isn't much of an effect  
5 of file-sharing on record sales. In fact, in the worst  
6 case scenario that we could find, file-sharing only  
7 displaced less than 3 million sales, which is less than 1  
8 percent of the total.

9           And in fact, we also show that file-sharing  
10 actually is a beneficial effect from lesser known  
11 artists. Again, perhaps reflecting some of this learning  
12 that I mentioned before.

13           But probably what's more important, I guess for  
14 people who are not economists in the audience, is what  
15 kind of conclusions can we say with very firm faith,  
16 something that you could for example say in a court room.  
17 And an economist would say what kind of statistical test  
18 can you -- what can you say with statistical confidence.

19           And I can tell you basically two main  
20 conclusions. We can't reject the fact that file-sharing  
21 has no effect on record sales, but we can reject the fact  
22 that even a quarter of the sales reduction that we saw  
23 during 2002, was due to file-sharing.

24           And in fact, the record industry now seems to  
25 somewhat agree with some of this, because if you for

1 example look at a recent issue of the economist, there  
2 was apparently an internal study at one of the big four  
3 labels that has come to the exact same conclusion as what  
4 we found.

5 So I don't have time to talk about all the sort  
6 of different ways we sliced and diced this data, but  
7 since Felix and I initially released this study several  
8 months ago, we have gotten thousands of eMails, and we  
9 spent lots of time dealing with, well, maybe Christmas is  
10 different and you want to get rid of that. Or maybe  
11 file-sharing shifts sales between albums; none of this  
12 changed our basic conclusion.

13 Again, I would be glad to talk to anybody who  
14 is interested about this later.

15 So what is it, again, to wrap things up. The  
16 first thing is, the only way you're to understand an  
17 activity like file-sharing is don't look at these time  
18 series evidence. They're just not at all convincing.  
19 You have to look actually at the activity, what people  
20 are downloading.

21 And when Felix and I went ahead and did this,  
22 we don't really find -- we find no evidence that file-  
23 sharing has significantly impacted record sales.

24 You would, of course, correctly say, well,  
25 record sales are down, what happened? And there's lots

1 of possible candidates. I'll just mention two. Again, I  
2 can give you lots of others later if you want.

3 One example is, of course, the macro economy.  
4 The fact that the economy hasn't done all that well.  
5 A second one -- and I'm jumping down to kind of the third  
6 bullet point on this slide -- is the growth of other  
7 entertainment alternatives.

8 Kids, particularly, have lots of different  
9 things that they can spend money on. Things like cell  
10 phones and video games. In fact, while record sales have  
11 gone down by about two-and-a-half billion dollars since  
12 filing sharing went on, video game sales are up over \$3  
13 billion.

14 It's not hard to argue that what's going on is  
15 not something that is due to file-sharing, but simply  
16 displacement from one kind of entertainment spending to  
17 another. Thanks.

18 (Applause.)

19 MR. HADEISHI: Thank you, Koleman. That was  
20 very interesting.

21 Our next speaker is Stan Liebowitz,  
22 representing a different economic analysis.

23 MR. LIEBOWITZ: Yes. You may wonder what the  
24 time series was that Koleman kept talking about that you  
25 shouldn't be paying any attention to. And that's going

1 to be, to some extent, what I'm talking about.

2 (Laughter.)

3 MR. LIEBOWITZ: Now, this is -- let me tell you  
4 that there is a paper outside if you want to learn more  
5 about this, and, also, that paper contains a discussion  
6 of problems with the data in measuring lots of Internet  
7 activity that I don't have time to really go into.

8 So that's the first thing. The other thing is  
9 sort of a more general point. There are some activities  
10 that you really don't need to do much in the way of  
11 econometric work to sort of know that there is a cause  
12 and an effect.

13 All right. So if one person walks up to  
14 someone else and punches them in the nose, and the nose  
15 starts bleeding, generally we can say we don't need to  
16 call an economist to find out what the cause was of the  
17 effect.

18 Now, what I'm going to suggest is that in fact  
19 we have essentially a punch that is pretty obvious, and  
20 then some bleeding that occurs right after.

21 But I will say that you can in fact go into  
22 things in more details, and I'll talk about those. And  
23 then I'll say that other people who have -- the last  
24 slide I have will be a listing of seven or eight studies  
25 by economists who look at this.

1 All of them come to a conclusion that is  
2 different than Koleman's. So it's not just time series,  
3 which Koleman has in fact complained about.

4 Now, the next slide gives you a bit of the  
5 history of record sales. Now, these are sales per  
6 capita, and they're using RIAA data, and I should mention  
7 that other people have mentioned Sound Scan data, which  
8 is fairly common. Sound Scan data comes from resale  
9 sales, and it turns out that that -- and this is about 25  
10 percent of the market.

11 It also turns out that if you look at the  
12 numbers that the non-retail data have had a considerably  
13 larger decline in sales than the retail data. So that  
14 there is a possibility you can get a miss measurement  
15 using Sound Scan data.

16 All right. What it shows is a fairly general  
17 increase with little upticks and downticks. Then, in  
18 1999, Napster starts, and you can see on the slide where  
19 it begins. That's the punch in the nose.

20 Then, you can see afterwards this decline that  
21 occurs, which is larger than any other decline that you  
22 can find over this period of time, and this is not a  
23 period of time that I just randomly chose. This is the  
24 longest period of time for which we have consistent data.

25 Prior to 1973, the RIAA did not put out

1 published numbers like this.

2 So what we have is a very large decline, no  
3 matter how you measure it, whether it's percentage terms,  
4 absolute terms, number of years it would take to get  
5 back. So if you take a look, we're at about four -- in  
6 2003, it's about four albums per capita. You would have  
7 to go back to either 1991, or, in reality to get a lower  
8 number, 1987.

9 So it's quite a large decline no matter how you  
10 measure it. And one of the things we would want to know  
11 is, if it wasn't file-sharing that did it, what did cause  
12 this decline? And Koleman has given us a few  
13 possibilities, and I'll mention those in a few seconds.

14 But one of them is not GDP. If you take a  
15 look, GDP, in fact, has gone up since 1999. There was  
16 only one year of a very mild recession in there. And if  
17 you were to just do a simple relationship between GDP and  
18 record sales, and then follow it through for the last  
19 three or four years, that's the blue line that you get  
20 there.

21 So in fact we might have expected, on a very  
22 naive GDP model, that record sales would have gone up  
23 over this period of time, and in fact the decline is  
24 larger than just measured from 1999, to 2004.

25 Now, why would we want to think that file-

1 sharing might be the cause of this, besides the fact that  
2 it occurred right when the sales started to decline, and  
3 that it started essentially -- the thing about file-  
4 sharing that is so unusual is it didn't sort of grow from  
5 something small and over a long time become large.  
6 Napster was up to its full size within a year, and it's  
7 not clear that there has been that much of an increase in  
8 terms of the number of files that have been downloaded  
9 since then.

10           The Pugh Survey numbers indicate something like  
11 50 percent. There are other numbers floating around, but  
12 this is one of the measurements that is off by at least a  
13 factor of 10, according to different people who measure  
14 how many files get downloaded. So it's not clear whether  
15 it's 200 million files a month that get downloaded, or 2  
16 billion. We don't seem to really know.

17           Right now, common sense, which we otherwise  
18 might say is economic theory to some extent, but some  
19 people -- not everybody, but some people -- are going to  
20 replace the purchase of a record with a downloaded  
21 product that they can get for free.

22           No one that I know says that every downloaded  
23 file is going to be a replacement of a sale. It's  
24 possible the recording industry might say that. They've  
25 said things like that in the past with other

1 technologies, which turned out not to be true.

2 But in this case, it seems -- it's very  
3 reasonable to think that some people are going to replace  
4 -- they have a perfect copy, and now that they have CD  
5 burners, which is why it took a few years to get -- to  
6 keep dropping as CD burners kept increasing. They have a  
7 perfect substitute for the purchase of a CD.

8 So we expect some substitution. It's hard to  
9 come up with any good reasons to expect there to be  
10 something to countervail the substitution effect, which  
11 is only negative.

12 Koleman previously had talked about sampling,  
13 and other people have talked about sampling, and Napster  
14 used sampling in its defense. That apparently is not  
15 anymore an important position for Koleman, but the fact  
16 is it's not clear that sampling is expected to lead an  
17 increase that would countervail the decline.

18 And so something else is presumably going on if  
19 you believe that it's not file-sharing.

20 Now, in fact, you can look at other  
21 alternatives independently. One of them is GDP, as I  
22 mentioned. The other one would be the price of CDs.  
23 That has been basically constant for 10 years. It has  
24 declined somewhat this year.

25 The quality of the music has been mentioned.



1 It's almost impossible to measure that, but the few  
2 attempts that I have made to do that, in the case that  
3 looking at radio listings here for concert revenues, no  
4 evidence that there is any decline in music quality.

5 And then there is the alternative forms of  
6 entertainment, which are probably the main -- best  
7 alternative to file-sharing. So we can take a look at  
8 some of them. The blue line here is video game receipts  
9 per capita. Revenues. And oh, yeah, they've gone up.  
10 They've gone up since 1996, 1997, 1998; they've gone up  
11 in a nice continuous, smooth fashion.

12 If you go back and look at that first chart,  
13 it's in 1999 that the music industry peaks, and 2000 is  
14 when it goes down. There's nothing here to make you  
15 think that something that changed in 2000 where suddenly  
16 video games became more popular than they were.

17 Now I have also included movies, but this is  
18 theatrical release, and nothing going on there, either.  
19 And just as Koleman was talking about time sharing and  
20 response to me, part of my presentation is in response to  
21 him.

22 In previous talks, he has talked about DVDs as  
23 being the primary alternative. It didn't really come up  
24 today, and maybe he's learned what's in this chart. But  
25 in fact, the lower blue line here -- and note that the

1 numbers on the axis are 1983 dollars. So they may not  
2 look totally realistic to you.

3 And note that there are two scales. And so  
4 there is a different scale for each line. So don't  
5 confuse the fact that the lines up here intersect each  
6 other.

7 The blue line represents units -- I'm sorry.  
8 DVD revenues sold. And looking at that, which is what  
9 basically people had -- that's what most in the  
10 newspapers and the media. You might think, gee,  
11 something really did happen in 2000. DVD sales took off.  
12 Maybe that would be an explanation, and that would look  
13 pretty good.

14 Now, what I pointed out in the past was there's  
15 also an increase in the late '80s, and it turns out that  
16 that period in the late '80s was when CD sales were doing  
17 very well.

18 But it turns out you don't have to do that at  
19 all, because if you look at video rentals, it turns out  
20 they were declining in the last few years, and they were  
21 declining by an amount so that when you take a look at  
22 total expenditures on whether you're renting or  
23 purchasing DVDs and VHS tapes, yes, they've been going  
24 up, but they've going up since 1994, 1995.

25 Nothing is happening in particular in 1999 or

1 2000 that could explain the sudden and dramatic change in  
2 CD sales. So that's not going to work either.

3 Now, there is other evidence from other  
4 sources. One is, and I interpret this quite differently  
5 than Koleman. In the first half of this year, sales of  
6 records were up slightly. All right.

7 But according to every estimate that I have  
8 seen of how much file-sharing is going on, in the first  
9 half of this year file-sharing is down compared to the  
10 first half of last year.

11 The reason for that appears to be the RIAA  
12 lawsuits, but every measurement shows that there was a  
13 decline in the middle of 2003, consistent with the  
14 lawsuits.

15 Now, there is, as you can see, a big variation.  
16 But nonetheless, we have all the measurements of file-  
17 sharing say it's down, and, guess what, sales have gone  
18 up a little.

19 So that's another piece of evidence supporting  
20 the claim that file-sharing is harmful to sales.

21 The last one is there is a paper by four  
22 professors at the University of Connecticut, and that  
23 paper takes a look at the K rates of albums. And they're  
24 not looking at it in terms of whether or not file-sharing  
25 is having to anything to do with it, but they happen to

1 have the numbers before 2000 and the numbers after 2000,  
2 and what they find is that the K rate is considerably  
3 greater now than it used to be.

4 Which is consistent with the substitution  
5 story, which is the first week it comes out for the  
6 albums that don't get on the on-line services before  
7 they're officially out, people still have to buy them  
8 because they're not available in great quantities on the  
9 services.

10 But in that second, and third, and four, and  
11 fifth week, they start decaying more rapidly because  
12 people can get them from the services and they don't have  
13 to go buy them anymore.

14 So that, again, is consistent with the story  
15 that says file-sharing is harmful.

16 So that's the conclusion. That there is no  
17 reason to believe that there is any other evidence,  
18 except file-sharing, for the decline that's occurred.

19 I should mention that there are -- I remember I  
20 started to interview with a woman 110 years old, or  
21 something like that, on television a few weeks ago. And  
22 I asked her why she lived so long. She said I drink a  
23 lot and smoke.

24 And I think, you know, if you see her, it's a  
25 cute little story, but I don't think it would be

1 considered as evidence that in fact smoking is good for  
2 you because she lived to 110.

3 So the fact that England or Australia may not  
4 have had a decline in the last few years in file-sharing,  
5 is not evidence that it doesn't in general cause a  
6 decline. I try to stick with countries I know best,  
7 which happens to be the U.S.

8 Now, it turns out you can do regression  
9 results, and I'm not saying we shouldn't do it. I'm not  
10 exactly a flat earther. I don't really believe you need  
11 to, but if you were to do regression results, here are  
12 the studies that have done regression results.

13 As I have said, you can go look at them, my  
14 paper outside references them. There are three  
15 dissertations here. One of them is at Harvard, from the  
16 economics department. There are other papers as well  
17 that use different techniques.

18 Interestingly enough, the one at Harvard uses a  
19 technique fairly similar to what Koleman does, and finds  
20 the exact opposite results that Koleman find. That the  
21 most popular albums do better. At least the version of  
22 the paper I saw, the top 25 percent of the albums are  
23 helped by file-sharing.

24 And in the Harvard study, the Blackburn guy, he  
25 finds the exact opposite. That a -- may not have much in

1 fact on the average record, but it has a very strong  
2 negative impact on the most successful records.

3 So quite interesting that it's so different.  
4 But all the others find some degree of harm. Three of  
5 them, including one that I have done, say that the harm  
6 is large enough to basically explain the entire fall, and  
7 others find that it's not actually capable of explaining  
8 the entire decline.

9 But the only saying that it's positive, or zero  
10 -- and it's actually positive in the numbers, unless  
11 you've changed your results since the April paper; barely  
12 significant, that's true, or maybe not -- you know, 90,  
13 88 percent confidence level.

14 But they're the only ones saying it's not  
15 negative. You can go and look for yourself. Thank you.

16 (Applause.)

17 MR. HADEISHI: I am going to allow Koleman and  
18 Felix to do a very, very brief response to that, if you  
19 don't mind.

20 MR. OBERHOLZER-GEE: Okay. Let me just say two  
21 things. The first one is the cute little story about  
22 someone punching someone else in the nose. Yes, it's  
23 true, we see that the music industry is bleeding. The  
24 key question is was it the short stocky guy, or was it  
25 the tall guy that punched the music industry in the nose.

1                   And in fact, we have a videotape. Koleman's  
2                   and my position is let's look at the data. Let's look at  
3                   the video tape. Professor Liebowitz' position seems to  
4                   be let's try to guess who the guy was who punch the other  
5                   guy in the nose.

6                   So that's the first part. The second thing  
7                   that I want to say about all the other studies that are  
8                   out there, our study, for reasons that I don't quite  
9                   understand, is the only one that has bothered to look at  
10                  actual downloads.

11                  Every --

12                  MR. LIEBOWITZ: The Blackhorn study uses data  
13                  from Big Champagne on downloads.

14                  MR. OBERHOLZER-GEE: Right. So what  
15                  BigChampagne measures is how many files are sitting on  
16                  people's hard drives. Right. So these could be  
17                  legitimate files, these could be downloaded files, we  
18                  don't know. And that is -- and then it's really easy to  
19                  see how you arrive at the negative relationship.

20                  What happens with the major release, is that in  
21                  the first few weeks sales shoot up dramatically, and then  
22                  they slowly decline over time. But the stock of sales on  
23                  people's hard drives develops relatively slowly.

24                  So guess what you find in the data? You find a  
25                  big positive effect in the beginning, and then as files

1 -- at the number of files on people's hard drives  
2 increases over time, sales drop off. That, of course,  
3 has nothing to do with the effect of P-to-P on sales.  
4 That's just a statistical artifact that comes directly  
5 from not using the right data.

6 So Professor Liebowitz obviously is a very  
7 smart person. He's made up lots of numbers here in a  
8 very creative way. What I would ask you to do, is do the  
9 second study, but actually look for downloads. Don't  
10 look at what's on people's hard drives. Look at what is  
11 being downloaded as we speak.

12 And then I'll be very interested to see what  
13 you find. I mean, the effect of P-to-P on sales is a  
14 moving target. Technologies change all the time.  
15 Consumer behavior might change over time.

16 It's interesting to study this, and I think  
17 economists are sort of in a unique position to do this  
18 because we have the methodological tool. But unless  
19 you --

20 A PARTICIPANT: Will you yield that time to  
21 those of us who have to actually speak, still?

22 MR. OBERHOLZER-GEE: Unless you look at the  
23 videotape, you're not going to find out who punched the  
24 guy in the nose.

25 MR. HADEISHI: Okay. And the rest of the



1 speech, let's try not to turn this into a personal --

2 MR. LIEBOWITZ: Let me just say that the  
3 videotape is a time series, and they're not doing a time  
4 series.

5 MR. HADEISHI: Okay. We're going to have more  
6 questions about the economic studies, since that's my  
7 inherent bias, but next up is Jonathan Potter, to speak  
8 about a large number of his members, if I'm not mistaken,  
9 are central server legitimate music downloading sites,  
10 and he's going to speak a little bit about what his  
11 experience has been.

12 MR. POTTER: Thanks. This is something new for  
13 me, watching economists squabble.

14 (Laughter.)

15 MR. POTTER: It's different than the way we  
16 lobbyists do it, and, you know, there's no respected  
17 colleague, like on the floor of the House.

18 I'm going to talk about three things quickly.  
19 I'm going to try to do it quickly. Quicker. I'm going  
20 to give you a quick overview of DMA, and who we are, and  
21 who our members are, and what they do, and how they fit.

22 I'm going to talk about impact on the market of  
23 what I call the black market networks. Other people have  
24 used file dissemination and things like that. I think  
25 black market network is a pretty apt term.

1                   And I'm going to talk about solutions.

2                   So DMA was formed in 1998, by folks like  
3                   RealNetworks and LiquidAudio, our members today are  
4                   Yahoo, RealNetworks, Amazon.com, as well as much smaller  
5                   companies.

6                   Our vision of the world is that the digital  
7                   world, digital distribution, web casting versus  
8                   broadcast, this is all just new media, new technology,  
9                   new business opportunities.

10                  Essentially our companies are in-betweeners.  
11                  We are in-between the creator and the consumer. Which  
12                  leads to our view of the Copyright Act, and the copyright  
13                  provisions in the Constitution, which were all about  
14                  creators and consumers.

15                  Anybody who is in between the creator and the  
16                  consumer, needs to be adding value to one end of that  
17                  chain or the other. Or they should get out of the way,  
18                  or they will soon be pushed out of the way if the  
19                  marketplace works.

20                  Now, we happen to think, selfishly, perhaps,  
21                  that digital innovation, digital downloads, web casting,  
22                  consumer influenced web casting; those sorts of services  
23                  that we offer, create efficiency. Create compelling  
24                  products and services. Consumers embrace them. Creators  
25                  embrace them, and, so arguably in the long term future

1 there is a role for our company to play.

2 We think there are also companies out there  
3 that don't seem to be adding value to the creators. That  
4 don't seem to be adding value to the consumers, or they  
5 cloak their value in low prices or free, but arguably,  
6 you know, there is things that undermine the value of  
7 free that other folks have talked about, and I think was  
8 talked about a lot yesterday when I wasn't here. Things  
9 like spyware and adware.

10 So sometimes free isn't so good as we all learn  
11 in the marketplace. But that's generally who our members  
12 are, what our philosophy is of how we look at it. And  
13 it's not just a copyright set of values, it's a  
14 marketplace set of values.

15 You're not creating opportunities to either  
16 benefit the creators with royalties, or with promotion,  
17 or with something that is really tangible to them and  
18 that they value, or you're not creating true value to the  
19 consumer, you know, you just really don't have a  
20 legitimate role.

21 Putting aside law. Law has nothing to do with  
22 whether you're playing a constructive role in the  
23 ecosystem here, in the creative ecosystem, and in the  
24 cultural dynamic.

25 Let's talk about the impact on the marketplace.

1 We've heard a lot about -- you know, from brilliant  
2 economists who dig deep and come up with all sorts of  
3 factoids that they, you know, are able to use for  
4 different arguments.

5 I would say as a casual observer and a reader,  
6 that there is a lot of statistics that go both ways on  
7 what has been the impact of black market networks on  
8 creators.

9 Part of it is how do you define the creator.  
10 If the creator is a record company who makes money  
11 selling plastic disks, or has traditionally made money  
12 selling plastic disks. It's pretty hard to say it hasn't  
13 harmed them. Probably in great significance. They have  
14 a single revenue stream, selling recorded music.

15 Now, if you're a creator, that is a band,  
16 perhaps it hasn't hurt your revenue, because, you know,  
17 the networks, the dissemination, the distribution of your  
18 music has created new fans who come to your concert, or  
19 who buy your t-shirts.

20 And so you have created new revenue streams  
21 that have offset other revenue streams. That would be  
22 the royalties off these CDs that perhaps are not selling  
23 so well.

24 Let me just note that in response to something  
25 Koleman said, I sat on many panels years ago that the

1 record industry had a broken business model, and it was  
2 broken because they were trying to sell two songs I liked  
3 with 12 songs I don't for \$18. And that was the physical  
4 model.

5 So I would actually say to Koleman the fact  
6 that a consumer has only two of the files from a CD,  
7 absolutely undermines the issue of whether he is going to  
8 buy that CD. He's not. He never wanted the other 12  
9 songs in the first instance.

10 So I -- you know, in terms of undermined sales  
11 of CDs just because the consumer only had two of the  
12 songs of a 12 track doesn't mean that he would have  
13 otherwise, you know, never bought that CD. He probably  
14 would have in the old world.

15 There is no question, and Stan Besen referred  
16 to this earlier, that black market networks, that piracy  
17 by consumers and infringement by consumers, absolutely  
18 undermines my company services.

19 Legal, paid for digital downloads versus free  
20 digital downloads. It's a single on this one, and it's a  
21 single over here. This is a no brainer. This is sort  
22 like getting punched in the nose.

23 So I don't know who's bleeding, I don't know  
24 who punched me, but I think it's pretty clear that one  
25 set of companies that is being hurt, is the Apple iTunes

1 business model, is the RealNetworks Music Store, and  
2 that's something that -- you know, so we feel fairly  
3 strongly about offering value and figuring out ways to  
4 make this market work. It makes it harder for our market  
5 to work.

6 For consumers, as I reference easier, one could  
7 make the case that the impact on the consumer has been  
8 positive. They get stuff for free. This is a good  
9 thing. I think the arguments were discussed aggressively  
10 yesterday.

11 I have had -- actually not through this sort of  
12 service, but I have had the unfortunate circumstance of  
13 having my browser high-jacked about six weeks ago. It  
14 was brutal.

15 So you know, adware, spyware, call it what you  
16 want, at the end of the day the big winners are the IT  
17 companies, or the IT consultants that come help you clean  
18 up your hard drive. Or you actually end up going out and  
19 buying a new PC because you really can't get it off your  
20 hard drive.

21 But I think consumers, all it takes is one bit  
22 of spyware, one bit of adware, and sooner or later they  
23 will give up and go back to legitimate services.

24 What's the solution; the solution is a  
25 comprehensive program that includes education,

1 enforcement, and a compelling legal alternative.

2 Consumer education, you know, we can educate consumers a  
3 lot about law.

4 Cable theft went down significantly when your  
5 neighbor was walked down the street in an orange jump  
6 suit with silver handcuffs. You know, it works. General  
7 deterrent works. When somebody down the street, somebody  
8 in your dorm gets busted, it works.

9 Having said that, it's perhaps not the only way  
10 to go. We can educate consumers about doing the right  
11 thing. My seven year old came home and told me that  
12 every time somebody smokes a cigarette, it knocks five  
13 minutes off their life.

14 Twenty-five years ago, we started an  
15 environmental education with that littering commercial,  
16 anti-littering commercial with the -- now we call the  
17 Native American, standing there with the tear dripping  
18 down his face because somebody littered, you know, on the  
19 road.

20 We teach people how to behave in society. We  
21 do it specifically in our homes. We do it in our  
22 schools, we do it broadly through the media. We can  
23 teach people that creativity has value. That creators  
24 deserve to be compensated, and that if we want more  
25 creativity, we have to figure out a way to encourage it.

1           We can also, of course, teach people about the  
2 price of freedom.

3           Let's talk about enforcement and law. We can't  
4 prohibit technology. We can't enforce out of existence  
5 any peer-to-peer technology or anything else. We can  
6 prohibit abuses of technology, as Andy Moss referenced.

7           We can prohibit or impose liability on  
8 parasitical businesses that make a living leeching the  
9 value out of one set of creators, and creating  
10 interesting, you know, business models, if you want to  
11 call it that; by imposing, you know, all sorts of  
12 collateral products and harms on consumers.

13           So if that's what the evidence demonstrates, if  
14 that's what people believe, we, as a society, can find  
15 out who is doing that and go after them.

16           We should also not give any credence to people  
17 who play chicken with the law. Hank Berry is an old  
18 friend. Hank Berry made an investment in Napster, and to  
19 some degree he played chicken with the law and he played  
20 chicken with the record industry. And he said "I think  
21 file-sharing is going to be so big, so big, that the  
22 record industry will have to come to their knees and  
23 license everything we want, because it's going to be the  
24 only thing left."

25           He rolled the dice; he lost. You know, the



1 litigation that's still going on. I've had a view about  
2 it. He rolled the dice and he lost. There's not a lot  
3 of pity out there for those who invested knowing of the  
4 uncertainty in the law.

5 The availability of the legal alternative, the  
6 marketplace, is really how we're going to win. We have  
7 to win by making content available. We're not going to  
8 win by not making it available.

9 So for the artists who sit there and say piracy  
10 is bad, but then don't license their content to Apple, or  
11 don't license it to Microsoft's MSN Music Store; they  
12 might as well escort their fans, their fans, right over  
13 to the black market networks. Because their fans are not  
14 necessarily buying their CDs, but they sure do want their  
15 music. And they'd sure rather have, you'd assume, virus-  
16 free high quality. Is it worth a buck? Yeah, it's worth  
17 a buck.

18 So we have to make the content available.  
19 Preferably by choice. Preferably not by a mandatory  
20 compulsory license, but if the marketplace truly doesn't  
21 work, that mat should be the way to protect artists and  
22 protect creators.

23 We have to make the system work at a fair  
24 price. We don't have to make the price lower than the  
25 marginal cost of the duplicate. We sell bottled water.

1 We put pretty pictures on the bottle, and we tell  
2 everybody it tastes better than tap, and some people  
3 believe it and some people don't, but everybody drinks  
4 it.

5 So we can defeat free. And we have to empower  
6 royalty paying innovation. The content industry  
7 shouldn't be trying to define the business models of the  
8 new in-betweeners.

9 Apple and Microsoft and Yahoo and RealNetworks,  
10 who are paying millions of dollars of royalties need to  
11 be empowered to create consumer influence web casting and  
12 to create subscription services to allow people to have  
13 three burns, or five burns, or 10 burns; whatever it  
14 takes to generate money.

15 Because that money then goes back to the record  
16 companies, it goes back to the publishers, it goes back  
17 to the songwriters, and it goes back to the recording  
18 artist.

19 And if our companies can't innovate to meet  
20 consumer demand in the marketplace, we know peer-to-peer  
21 gives consumers the power to go elsewhere, and that just  
22 hurts the creators. Thank you.

23 (Applause.)

24 MR. HADEISHI: We're now going to hear from Les  
25 Ottolenghi, President of INTENT Media Works.

1 MR. OTTOLENGHI: I want to thank the FTC for  
2 the invitation to speak before you this morning. I think  
3 I was brought up here because I am neither an economist,  
4 nor am I a lobbyist, an attorney, I am not a member of  
5 the RIAA, the MPAA, or any other association other than  
6 the DCIA.

7 And actually, I have a happy presentation.

8 So --

9 (Laughter and applause.)

10 MR. OTTOLENGHI: -- I've got something good to  
11 say about what's going on, and by way of backdrop for  
12 that, let me play a little movie for you. This is what  
13 our company does. So this is a more interactive  
14 presentation for you.

15 A PARTICIPANT: Do you have the legal right to  
16 play this movie in public?

17 MR. OTTOLENGHI: You know, I actually made this  
18 movie myself. So I am authorized through my own  
19 licensing of this particular presentation.

20 (Laughter.)

21 MR. OTTOLENGHI: Now, some of it's cut off here  
22 at the bottom, which -- just for the reason of the  
23 presentation screen and the resolution.

24 But what our company does is we distribute  
25 content -- music, videos, EBooks, software, and games --

1 vis-a-vis various distribution methods. So digital  
2 distribution platforms. Specifically, peer-to-peer web  
3 sites where we syndicate content. Various web sites for  
4 download. Satellite radio, television, and now, we do  
5 integration with PC to TV. So from the PC to the TVO, or  
6 the personal video recorder, et cetera.

7 And if you want to know more about this, and I  
8 won't bore you with the rest of the details of it, you  
9 can go to our web site and just take a tour around the  
10 web site and see what we do.

11 We have several major artists in the music  
12 industry who are part of our portfolio, and we're really  
13 a new business model. We're a platform, if you will, for  
14 innovation and distribution through peer-to-peer.

15 By way of a little bit of a backdrop, there was  
16 a mention by Peter earlier today about travel agencies.  
17 We are part of a seven-year-old company that actually  
18 started out by creating software which would aggregate  
19 reservations from various web sites around the Internet  
20 and put it in one screen at one time.

21 So if you've used Orbitz or Travelocity, you've  
22 used our technology. Where you find content from several  
23 sources in one place, very similar to peer-to-peer. So  
24 legitimate use of technology, meta search technology.

25 We've done the same thing in the job placement

1 and job hunting industry. And finally, we turned our  
2 sites on to music and media distribution industry because  
3 we believed there was a better model, and one of the ways  
4 to effect that better model was to use the peer-to-peer  
5 networks.

6 So what do we do, we talk to the content rights  
7 holder, the artist, publisher, whoever it may be. And we  
8 secure rights to distribute their content legitimately in  
9 an authorized fashion through the peer-to-peer systems.

10 In fact, we do this so effectively that we're  
11 working even with the FBI to find people who don't do it  
12 in an authorized way. And we work with the DIA in an  
13 effective way to bring content legitimately to the  
14 peer-to-peer networks.

15 We combine all of this with an effective viral  
16 marketing technique. Meaning we put additional content  
17 and information around the media, the actual music, or  
18 the song. And we provide additional information for the  
19 consumer, so they're more interested in our files, rather  
20 than the free and illegitimate files. So we add value.

21 And we also add value by connecting those files  
22 to the web so that if someone finds an artist that they  
23 like, they can learn more about that artist by clicking  
24 on the actual song, or the splash page that comes with  
25 the song and go directly to the artists' web site and

1 interact and engage in further commerce.

2 We provide content, as I mentioned, across many  
3 channels, and in the interest of time, I won't go back  
4 over this. And we do it in a way which enables both paid  
5 and free content.

6 So let me stop on that point. We enable an  
7 artist or a copyright holder, or a content rights holder,  
8 to actually sell their content through peer-to-peer, or  
9 to work with one of our advertisers who will support  
10 their content, pay them for the content, and make the  
11 content available for free over peer-to-peer.

12 We have now also signed up with every paid  
13 search provider, except for Google, and we provide paid  
14 search ads which underwrite the cost of those files, or  
15 the compensation back to the rights holder.

16 So that the file is now offered, or the music  
17 is offered, at a lower price point. We've actually  
18 effected this in the peer-to-peer environment.

19 We then use, as I mentioned before, advanced  
20 technology. Some of the multi-media technologies.  
21 Technologies which enable samplers, equalizers, eBooks,  
22 portfolios; all in multi-media form which accompany the  
23 music file, when we talk about music distribution over  
24 peer-to-peer. And incent people to want to listen more  
25 to that content and go buy more content, or subscribe to

1 marketing programs where they can get that content for  
2 free.

3           Unlike most of the debate in the last two days,  
4 this is for real. This happens today. It's not  
5 theoretical, it's not based on time snapshots and time  
6 frames, or whatever else it may be. But frankly, it's  
7 quite open to debate as to whether that information is  
8 absolutely legitimate or real.

9           I think Professor Michael Smith yesterday  
10 actually had the most legitimate statements about this,  
11 which was that you have to look at the real numbers. You  
12 have to look at the models, and you have to incent new  
13 models to be put forth for distribution through  
14 peer-to-peer.

15           Today we're able to work with several partners.  
16 Those partners include peer-to-peer software companies.  
17 One of them is here today, which is EDonkey. The others  
18 are Altnet and BearShare.

19           Now, we have approached several other  
20 peer-to-peer software companies, and they're all thinking  
21 about working with us, but to date we have not been able  
22 to incent anybody from the major studios, or, for that  
23 matter, from major record companies, to work with us  
24 directly. And we are a legitimate company that is not a  
25 peer-to-peer software company and we are doing the right

1 thing. We are putting legal and authorized content onto  
2 those networks.

3 And I would like very much for any of the  
4 members of the RIAA, or MPAA to come and work with us,  
5 because we can take your content out there legitimately.  
6 We can distinguish it from free, and we can make it  
7 interesting and incentive for consumers.

8 It's also a bridge in the model between what  
9 you're doing and what the peer-to-peer companies are  
10 doing. We work with P-to-P revenue engine, which is the  
11 DCIA initiative, and this very simple slide here, which  
12 is easy to understand --

13 (Laughter.)

14 MR. OTTOLENGHI: -- was a creation of mine.  
15 Unfortunately. Such is life.

16 It is part of an initiative which we can  
17 provide secure distribution through the peer-to-peer  
18 systems through this technology. The combination of 10  
19 companies working together. Some of whom are represented  
20 here, some of whom are not, but who can legitimately put  
21 content, since we have tested and integrated this  
22 technology ourselves.

23 We have detailed information every time we  
24 distribute a file on the behavior and actual use of  
25 content. I see I have two minutes left.



1           And with that, we are able to ensure marketing  
2 programs with content rights holders, and a relationship,  
3 which is the most important thing.

4           There was a statement just a moment ago about  
5 dragging your customer off in handcuffs in an orange jump  
6 suit. I am pretty sure, and I am not an academician or a  
7 lobbyist, that is not a good way to keep customers.  
8 Okay. That doesn't incent them to want to work with you.

9           So if you do have a legitimate way to work with  
10 them, a real business model -- and I really think it's  
11 important for the Federal Trade Commission to understand  
12 that if there is a legitimate business model out there  
13 that's being developed, that they should encourage the  
14 various parties to participate in working on such a  
15 model. If not ours, something like it, because this does  
16 work, and it works today.

17           If you want to know any more, please do go to  
18 our web site, or take a look over the peer-to-peer  
19 systems. I have some examples here with hyper links. I  
20 know that this presentation will be made available  
21 on-line by the FTC. You can click on it, and actually  
22 take a look at some of our content on-line.

23           Some of you saw this magazine in the last day  
24 or two, which has one of our artists, Jillian Ann. No,  
25 she does not have a costume malfunction. This is a --

1 she was a model, and now she is a music composer and a  
2 musician, and she averages about 2 million impressions  
3 ever week on-line just for her music.

4 And approximately 200,000 downloads a month,  
5 and she has gone from having to work as a part-time  
6 waitress and hostess and so on, to now a full-time  
7 musician as a result of distribution through P-to-P.

8 I would say that there are several other  
9 Jillian Anns out there. Her case study is here in the  
10 MIT Magazine of Innovation, the technology review  
11 magazine. But we have several other case studies in that  
12 we have 5,000 musicians. We have over 10,000 films,  
13 independent films from student film festivals, the  
14 winners of the last five years; and these things are  
15 doing very well over peer-to-peer.

16 I would encourage this entire group to look at,  
17 the FTC in particular, positive business models. If  
18 legislation and fighting in the courts is the thought on  
19 how this is going to be resolved, that's a complete  
20 mistake because the public is ultimately what drives this  
21 content commercial use. Thank you.

22 (Applause.)

23 MR. HADEISHI: Thank you, Les. That was very  
24 interesting.

25 Our next speaker is Sam Yagan, president and

1 CEO of EDonkey, if I'm not mistaken. And I actually  
2 don't know what Sam is going to tell us about. So this  
3 should be interesting.

4 MR. YAGAN: I hope you all are not too  
5 disappointed that although I have been called a pirate, I  
6 don't dress like one.

7 (Laughter.)

8 A PARTICIPANT: Where's the bird?

9 MR. YAGAN: Or the eye patch. I left mine at  
10 home.

11 First, I want to thank the FTC for hosting what  
12 I believe is the first panel of its kind and having such  
13 an open forum of all sides of this issue. Again, I am  
14 neither a lobbyist nor an attorney, so my role here, as  
15 Haj said, it's not clear, but hopefully my perspective  
16 will be at least a little bit unique and interesting to  
17 those of you who may not know what it's like to be on the  
18 inside of one of these companies.

19 I am the president of EDonkey, also a founding  
20 member of P-to-P United, who you heard from yesterday.  
21 EDonkey right now is by most accounts the most popular  
22 file-sharing software in the world.

23 We are a New York company, we're actually  
24 incorporated in the United States. So like the recording  
25 companies, we do employ Americans, and we pay taxes.

1 (Applause.)

2 MR. YAGAN: And I don't think any more  
3 peer-to-peer companies will incorporate in the United  
4 States as long there is this ambiguity in the legal  
5 process. So we are driving innovation offshore.

6 I had some remarks prepared, but so much has  
7 transpired in the morning I have been here that I felt it  
8 was important to at least comment on some of what I have  
9 heard so far.

10 Where to start? First, in response to Mr.  
11 Garfield's comments this morning. There has been a lot  
12 of debate about what the solution is. Is it filtering,  
13 is it something else.

14 And what has occurred to me is that it's not  
15 our decision what the solution is. It's the consumer's  
16 decision what the solution is. We could be sitting here  
17 debating whether a car should have three wheels or five  
18 wheels. A perfect example is hyper-technology in cars,  
19 right? Pretty much everyone would agree that cars should  
20 use more efficient engines, but that's not what the  
21 consumers are ready to embrace yet.

22 So when we sit here and we think about what is  
23 the right answer, we have to keep in mind it's not my  
24 decision, and it's not Mr. Garfield or Mr. Sherman's  
25 decision. It's the consumer's decision.

1           Also, Mr. Garfield, you talked about the profit  
2 motive as though this were this terrible thing. That we  
3 were motivated by profit. And so I have been thinking  
4 about that a little bit. I think that is actually in the  
5 rights holder's interest that software companies are  
6 motivated by profit, because what that means is we  
7 actually want to make money selling music. That's where  
8 all the big revenue is coming from.

9           What would be more fearful to me would be these  
10 rogue anarchists, who might not be profit motivated.  
11 Someone talked about BitTorrent and Graham Cohen. That  
12 is more frightening. He is not motivated by profit.  
13 He's motivated by just developing peer technology.

14           So in some ways I think the profit motive is  
15 not a bad thing for the recording industry. In fact, you  
16 might want to embrace that and say, well, how can we help  
17 you, the software companies, make more money.

18           Another issue that has come up is whether this  
19 filtering technology is viable. Can it be done  
20 centrally, decentrally; and it occurred to me that this  
21 seems to be something that has a factual answer, but that  
22 the sites seem to disagree on.

23           So Mr. Sherman and Mr. Garfield, I hope you  
24 will join me in calling for an impartial study sponsored  
25 by any group of people, the FTC, or other; to actually

1 investigate from a scientific perspective, throw the  
2 lobbyists and lawyers out of the room, and let's see if  
3 this is actually possible. I hope you'll agree to do  
4 that later on when you respond.

5 I'll reiterate what Mr. Moss said earlier, that  
6 the technology is just a tool. I won't hit on that too  
7 much, since that's been repeated by lots of people. But  
8 what's important is that the use of technology is very  
9 dynamic. It changes over time.

10 So when you look right now how is the  
11 technology being used, it would be a real danger to  
12 extrapolate and say that is how the technology will  
13 always be used. And the case in point is imagine if when  
14 the VCR came out, none of the motion picture companies  
15 released their theatrical hits on VHS.

16 Well, of course, the VCR would not be used for  
17 legitimate purpose of renting those movies, because they  
18 would not have been made available.

19 So I would ask that if you want to increase  
20 legitimate use of these networks, let us sell your music.

21 I think everyone has already hit on the fact  
22 that peer-to-peer is here to stay. It's important also  
23 to recognize that, you know, the technology of these  
24 peer-to-peer applications goes well beyond our companies.  
25 Just like if Microsoft goes out of business, your

1 Internet Explorer will still work. All of our networks -  
2 - all of our software will continue to work regardless of  
3 whether the companies actually exist.

4 Fourth point, peer-to-peer is evolving very  
5 rapidly. Napster went away, so Kaza and Morpheus and  
6 EDonkey came up very quickly. The next generation of  
7 this software will be fully encrypted and fully  
8 anonymous, and you won't be able to tell who is using the  
9 software and what's being shared on that software.

10 So it's just important that we do look forward  
11 in looking at what are the possible opportunities with  
12 the software, instead of just saying what is the current  
13 state of the art, and what is the past state of the art.

14 The technologists and entrepreneurs who are in  
15 the P-to-P software development space, ourselves, are  
16 struggling to keep track of the technology and stay on  
17 top of what's going on.

18 So when we think about what are the rights, you  
19 know, should there be government regulation or government  
20 intervention, litigation, legislation, I think that you  
21 have to think that who is really well positioned to  
22 predict the future in this technology. And I would argue  
23 it's probably no one.

24 And so when we resort to these -- when we  
25 resort to these kind of regulatory solutions, there is a

1 real risk that we're going to get it wrong anyway. So  
2 this is not going to be a cure all.

3 I have a quick digression. I want to tell you  
4 all a quick story about my first experience with file-  
5 sharing. This is a cassette tape that was given to me by  
6 my best friend in high school, and that contained on it a  
7 mix of U-2s greatest hits up to that time.

8 I had never heard of the band. I was kind of a  
9 nerd in high school. Apparently they were a big band.

10 (Laughter.)

11 MR. YAGAN: I didn't really know that at the  
12 time. And so he gave me this, and I kind of didn't like  
13 U-2 the first time I heard it, and I couldn't really  
14 understand what was going on. But I listened to it  
15 pretty much every week for the course of my sophomore  
16 year in high school, and by the end of the year, I  
17 totally fell in love with U-2. I just loved it.

18 And so I was preparing for my talk today, and I  
19 thought how much money have I spent on U-2-related  
20 paraphernalia? So this includes CDs, bands, you know,  
21 tickets, concert tickets, posters, whatever; I've spent  
22 over \$2,000 on U-2 paraphernalia, including albums. I  
23 have every one of their albums.

24 And so it occurs to me that this is file-  
25 sharing, and one customer on one band spent \$2,000.



1 That, to me, seems like a good thing for the artist and  
2 for the recording industry.

3 One undeniably positive effect of peer-to-peer  
4 on the consumer, is, in a word, iTunes. With all due  
5 respect to Mr. Jobs, I would argue that it is the  
6 peer-to-peer software that really reinvented the single.  
7 Would iTunes be there selling singles had not singles  
8 become so pervasively available on peer-to-peer software  
9 applications?

10 So you know, again, that's a way you -- you  
11 might not have predicted when you first saw peer-to-peer  
12 application that what this is going to do is, this is  
13 going to deconstruct the album -- the idea of having to  
14 buy two songs to get the 14 songs you don't want. That  
15 is no longer a constraint to consumers that I would not  
16 have predicted, but it clearly was an effect.

17 So one of the questions I was asked to talk  
18 about is, is P-to-P just like Walmart.com, or iTunes?  
19 And there are too many reasons why it's not. The first  
20 is comprehensiveness. A good on-line store I think has a  
21 million tracks, tops, and a good -- you know, on the  
22 P-to-P world, there's probably about a hundred million  
23 unique files.

24 And so I was actually trying to find U-2's 2001  
25 Chicago performance on their Elevation Tour, and it turns

1 out I really can't buy that anywhere.

2 So did I go to EDonkey, as you might expect,  
3 and download it. No, I didn't, but I went to EBay, and I  
4 was able to buy a version. And I'm afraid that nobody --  
5 none of the rights holders actually got the payment for  
6 that. It was probably some guy who just taped it on a  
7 bootleg.

8 So that exists. And then there is this issue  
9 of community. People are tied together by music, and  
10 that's great news for the music industry. People  
11 congregate around your product.

12 And so I think that's something that the P-to-P  
13 applications offers, is that community sense. And this  
14 is only the tip of the iceberg. As voice over IP and  
15 social networking becomes more embedded into these  
16 applications, it's only going to become more sticky.

17 Okay. Real quick, since I'm running out of  
18 time. There is all this debate about the artist, in  
19 particular the poor artist versus the rich artist, let's  
20 say.

21 In my other pocket, I have a CD from a band  
22 called Bishop Alan. I suspect no one has heard of them.  
23 And that's because there was no record label that would  
24 sign them. So they have -- we've been promoting them on  
25 the EDonkey software for the better part of the last

1 year, and we are helping them to do their own really hard  
2 work. They just completed a profitable, very profitable,  
3 nationwide tour, and they reached number two best-selling  
4 album on Amazon.com.

5 Now, figure that. If they don't have record  
6 label support, all they have is their hard work, and  
7 distribution on a P-to-P application. Number two on  
8 Amazon.

9 I have been hearing a lot about you can't  
10 compete with free. These guys would tell you otherwise.

11 The last point, and I will actually stop there,  
12 does P-to-P threaten the music industry? I think that's  
13 kind of a central question we're all here to talk about.  
14 And the answer is, it doesn't, because we're not in the  
15 music business. We're in the software business. The  
16 real threat to the music industry -- and, here, I'm out  
17 of my league, because I'm not in the music industry.  
18 But I would suspect the risk to the music industry is  
19 someone like me, an enterprising entrepreneur, says, you  
20 know what, what if I leveraged the possibilities of  
21 P-to-P and created a music company that basically did a  
22 lot of what this band, Bishop Alan did, leverage P-to-P  
23 to make money.

24 Cutting -- so, Mr. Sherman, I believe you said  
25 so many people worked behind the scenes in the music

1 industry; well, that's part of the problem, I think. I  
2 think the efficiency of P-to-P is that you don't need as  
3 many people working in the industry.

4 And you said your -- where 90 percent of your  
5 investments fail; again, that's a problem with the model  
6 I think. I think we can improve on that, and we can get  
7 -- if you've got the members of the P-to-P software  
8 application saying this is good music, you're going to  
9 get 60 percent hit rate, because you won't have as many  
10 losers.

11 And then you talked about the complicated  
12 license situation, and, again, that's a constraint of the  
13 industry that says we can't figure out often who owns  
14 which right, and therefore we can't sell them. Again,  
15 that is a challenge for the industry to change, and say  
16 we can improve on the system.

17 I think the movie industry is in much better  
18 shape, but I'm out of time. So I can talk about that  
19 later.

20 (Applause.)

21 MR. HADEISHI: We're going to switch gears  
22 completely, and Mr. Newton is going to sing us a nice  
23 little song. And did I mention Bubba is in Baghdad is  
24 coming out on major radio next week?

25 MR. NEWTON: Thank you, Haj. What a pleasure

1 it is to be back in Washington, D.C. My wife is a visual  
2 artist, and we're in high cotton when we're up here.  
3 This is -- we spent yesterday going through the new  
4 American Indian Museum, and if you haven't been to that,  
5 you need to put it on your list.

6 I'm representing the National Songwriters  
7 Association. This is my fifth trip to D.C. for the  
8 purpose of fighting for our rights. And it's been quite  
9 an education.

10 Before we get into that, though, I should tell  
11 you that our motto in Nashville for the Songwriter's  
12 Association is "It All Begins With A Song." So I'll  
13 start with this song, and you can -- we are the only  
14 organization or profession that I know of, or one of the  
15 few, that is so big-hearted that we have training  
16 sessions in all states. Anybody that wants to start a  
17 chapter in your little town can do it, and we will help  
18 train you to replace us.

19 So I mean, I don't know how smart that is, but  
20 we are -- we are pretty unique. I also should tell you  
21 that there used to be an organization similar to that in  
22 Los Angeles, but I don't think they could get together.

23 So I'm going to give you a little songwriting  
24 lesson. And has anybody ever tried to write their own  
25 song? All right. Content providers, there are content

1 creators and owners. It's really pretty easy. You  
2 should try it. It's really easy to write a bad song.

3 (Laughter.)

4 MR. NEWTON: And this one may fall into that  
5 category, but this song was inspired from my first trip  
6 up. I asked somebody on the way up on the plane, I said,  
7 well, what does the Constitution say in that gave us this  
8 copyright? And one of our writers just happened to have  
9 the pocket Constitution in his pocket, and he showed me.

10 And it's right there on the same page where the  
11 government is able to have an army, to build roads, to  
12 have post offices. And just in a few short words, they  
13 mention this thing about copyright, and I tried to  
14 memorize it. It's not easy when you're -- it's not easy  
15 to do. But I found that songs are much easier to  
16 remember than just speeches.

17 So I wrote this little song. It's called -- it  
18 has two titles. One is called Article I, Section A.

19 (Laughter.)

20 MR. NEWTON: But it also could be called  
21 Promote To Progress.

22 (Plays guitar and sings.)

23 (Applause.)

24 MR. NEWTON: Wow, thank you. You know, I  
25 really -- I haven't even recorded that one yet. I never

1 thought about it, although I played it in front of a  
2 bunch of lawyers down in Nashville. They were there to  
3 learn about the music industry, and they liked it, too.  
4 They had a Power Point demonstration up where it showed  
5 the -- that was there to kind of teach some of the  
6 lawyers who were not in the music business about it.

7           And they had this illustration up there where  
8 it says, the RS and the publisher, and the record  
9 company, and the managers, and on, and on. Just a whole  
10 network of people who derived their benefits and their  
11 income from our industry.

12           And of course, the artist had a star around it,  
13 but somewhere down there was songwriter, in small print.  
14 They changed it when I brought that up. They made it  
15 biggest of all, and really -- and really, that's the way  
16 it should be.

17           But the experience of songwriting from that  
18 point of view, Nashville is a mecca for songwriters.  
19 It's not just country music. We have artists from all  
20 genres there, and we have brought them together because  
21 of our love for our craft and art. And it's quite a  
22 community.

23           And I'm here because we want to be in the room  
24 on every issue that comes up before the government. We  
25 were not here in 1909 when they wrote the first copyright

1 law. We were not in the room. What happened? The  
2 original draft of that copyright law had nothing for the  
3 songwriter. But some staff person asked about it, and  
4 they said, well, okay, we'll give them a penny.

5 So that in 1909, we started out with a penny.  
6 Now, here it is -- who knows what the compulsory license  
7 and dollar amounts are, who knows how much that  
8 compulsory license is right now for a songwriter?

9 Eight-and-a-half cents. Did anybody -- was  
10 everybody aware of that? Because when we started  
11 educating the Congressmen and the Senators -- and, by the  
12 way, we come up once a year, we bring about 30 of us --  
13 and since we started doing this about four years ago, we  
14 have met with over 400 members of Congress.

15 We now have a songwriter caucus in the House,  
16 and expect to have one in the Senate next year. Lamar  
17 Alexander is a pretty good piano player. He can play a  
18 Hank Williams song, or anything else. I think he might  
19 want to be a songwriter. I don't know.

20 But when we got to these meetings, we strap our  
21 guitars on and we talk about our very basic issues, and  
22 when you think about that, eight cents -- it's now eight-  
23 and-a-half cents, right?

24 Okay. How is that -- so if I'm a co-writer,  
25 which a good number of the songs these days are



1 collaborations. So if I'm a co-writer and I have a  
2 publisher, then that only leaves me with a quarter, 25  
3 percent of that. That's two cents.

4 So if I'm on a big hit album that sells a  
5 million records, do the math. You know what that comes  
6 out to? \$20,000. Those cuts are really hard to come by.

7 What that comes down to, if I'm signed to a  
8 publisher, on an advance, if I'm lucky, and with \$20,000  
9 I could sign you a room full of songwriters by the end of  
10 next week. I can promise you that, \$20,000 a year.

11 My first deal was for \$75 a week, and I was  
12 really happy to have it. But that \$20,000 that goes to  
13 pay back their advance, and if you do that very long, you  
14 get into the red ink, you won't have a deal anymore.

15 And I can tell you, in our community there are  
16 some of the greatest songwriters who have written songs  
17 you have -- that you fell in love to, or that you've  
18 partied by, or that you may have played at your funeral  
19 or the funeral of one of your loved ones; these songs,  
20 some of these writers, are struggling. They may have  
21 made a lot of money, but it's that income stream can go  
22 up and down.

23 To illustrate that, one of the metaphors I use  
24 is that it's kind of like being a family farmer without  
25 any subsidies. And if you're with a publisher, really

1 what that makes you is a sharecropper.

2 I want to mention real -- I want to plug  
3 another songwriter, who is really on a roll right now.  
4 And that is the great Stephen Foster. And you're  
5 laughing. But I was involved with a project, it's called  
6 Beautiful Dreamer, The Songs of Stephen Foster, who died  
7 something like 150 years ago, but his songs are so  
8 compelling that somebody finally came up with a great  
9 idea of getting 18 artists together, and they include  
10 Alison Krauss. Her cut includes -- has YoYo Ma, and Mark  
11 O'Connor, and Edgar Meyer on bass. It's amazing. Ray  
12 Mallow does Beautiful Dreamer.

13 By the way, Beautiful Dreamer, have you heard  
14 the new Mercedes commercial? So he's on a roll, but I  
15 don't know if he's turning in his grave as all this is  
16 going on, because he died with 38 cents in his pocket.

17 He was the first professional American  
18 songwriter. He had moved to New York, kind of -- he made  
19 some pretty good money, but a lot of these issues that  
20 we're talking about today were still on the table at that  
21 time.

22 So I'm excited about the technology that we're  
23 talking about today. I have become an entrepreneur. I  
24 have my own record label, my own publishing company. I  
25 do my own photography for my albums. I've got a web site

1 now. I want to cut out as many people on that chart as I  
2 can.

3 (Laughter.)

4 MR. NEWTON: Because that two cents has just  
5 not been getting it. So I can happily say that if we can  
6 -- when we learn how to protect our rights, and I know  
7 the technology allows all this to happen can also monitor  
8 these songs without invading anybody's privacy. The  
9 songs that are played on the radio are monitored by a  
10 company has a digital finger print of our music, and  
11 every time one of them gets played, it's like a little  
12 odometer that goes over and a few cents go into our  
13 pocket from that.

14 So I'm all excited about that technology and  
15 using it to help the creativity, but I want to point one  
16 other thing. Because this gets down to if we're talking  
17 about surveys and what effect it's having.

18 One of our real powerful tools on our last  
19 trip, we brought a little poster. And there were all  
20 little postage stamp pictures of real estate on Music Row  
21 that is for sale. It's unbelievable. Music Row is  
22 pretty concentrated in about 10 blocks near Nashville,  
23 and it is unbelievable what is happening.

24 It is all about the perceived notion of what's  
25 going to happen in the business, and people putting their

1 money behind it.

2 And so that is one very strong effect. And we  
3 don't call it file-sharing down there, we call it file  
4 stealing, because that's what is if it's not paid for.

5 So thank you very much, and I'm glad to be  
6 here.

7 (Applause.)

8 MR. HADEISHI: Thank you, Mr. Newton. We trust  
9 you'll send us a wave file, and give us the rights to  
10 distribute this on our web page.

11 Michael has the unfortunate position of  
12 following that. Michael is the co-founder and policy  
13 director of the Future of Music Coalition.

14 MR. BRACY: Yes, I kind of have the Triple  
15 Crown today because I'm the last speaker in a two-day  
16 forum. I don't have a song, and I don't even have a  
17 slide show, but I've got a heck of a statement.

18 So we're just going to rip through this, and  
19 we'll be out of here. So I appreciate you all making  
20 time.

21 My name is Michael Bracy. I'm a founder, and I  
22 am the policy director, of the Future of Music Coalition.  
23 The Future of Music Coalition is a non-profit that  
24 identifies, examines, interprets, and translates the  
25 challenging issues that are at the intersection of music,

1 law, and technology, and policy.

2 Today, we're going to do two things in my  
3 remarks. We're going to try to take the discussion we've  
4 had for two days about peer-to-peer and put it into a  
5 broader context about what's happening with the  
6 technology, and what's happening with the music  
7 community.

8 And I'm also going to talk a little bit about a  
9 study that we worked on with the Pugh Internet and  
10 American Life Project. I encourage you all to go to  
11 FutureMusic.org to learn more about the work we're doing,  
12 but also to read the complete Pugh Study. There's a lot  
13 of interesting information in that.

14 The music community is in the midst of a  
15 necessary and a welcome transition to new digital  
16 business models. Now, historically, the musicians have  
17 aligned with major labels for three core reasons; for  
18 access to resources like budgets, staff, money, core  
19 support, access to distribution, to retail, to promotion,  
20 to basic infrastructure, and access to radio, TV, you  
21 know, basic promotional opportunities.

22 And for many this has been a good model. It's  
23 worked. But for many others, it hasn't been particularly  
24 good. And there have been a lot of challenges in this  
25 model, including concerns about contracts, accounting,

1 business strategies, priorities, and FMC is one of many,  
2 many organizations that have been working in the  
3 Coalition to try to look at these issues and try to  
4 address them.

5 Now, two very significant developments have  
6 really forever altered the music landscape, and this  
7 really happened in the late '90s; market consolidation  
8 and digital music.

9 Again, we have spoken a lot, and partners in  
10 the music community have spoken a lot about our concerns  
11 about the impact of concentrated control on the radio,  
12 among the major labels about what has happened retail,  
13 what's happening in the concert industry, and so I'm not  
14 going to talk about that today.

15 But this -- you know, we need to understand  
16 this is taking place in a broader discussion about  
17 consolidation. I think particularly with radio and  
18 concert venues.

19 Now, at the same time that the music landscape  
20 was seeing this consolidation, there has been a  
21 remarkable technological innovation as we're shaping the  
22 way the music is recorded and manufactured, promoted, and  
23 distributed.

24 Digital studios and software dramatically have  
25 reduced production costs. The Internet vastly increased

1 promotional and sales opportunities. The marketplace for  
2 independent music exploded, and new labels proliferated  
3 the service community.

4 Now, a lot of this music was not intended to,  
5 or simply didn't make sense for the kind of mass  
6 audiences that really was of most interest to the major  
7 labels and to radio. But there was a market for this  
8 music. A big market for this music. And so alternate  
9 and Internet based economies began to take shape.

10 Now, as these models took flight, some  
11 companies and labels offered more equitable business  
12 relationships for artists. Some allowed artists to keep  
13 their copyright. Some offered creative control. Others  
14 provided higher royalty rates.

15 Many musicians have embraced these, these  
16 models that allow greater independence, direct contact  
17 with fans, more control over their careers; just one  
18 example, CD Baby is an on-line retailer, similar to  
19 Amazon.com.

20 As of yesterday, nearly 80,000 independent  
21 artists were offering their CDs for sale via CD Baby. CD  
22 Baby has paid out over \$11 million directly to musicians.

23 So for artists and independent labels, the Internet  
24 allows for streamline promotion and distribution via  
25 digital music stores, Internet radio web sites. It gives

1 musicians the tools to easily and inexpensively connect  
2 directly with fans.

3           And so in this context, the results of the Pugh  
4 Study that was released on December 5 really should not  
5 be viewed as particularly surprising or controversial.  
6 The report found that artists have a broad range of  
7 opinion when asked their views about digital music  
8 technologies. The report indicated that musicians use  
9 the Internet to promote and to sell their work -- 87  
10 percent of the 27,000 musicians who participated in the  
11 survey said they promote, advertise or display their  
12 music on-line. Eighty-three percent provide free samples  
13 or previews of their music on the Internet; 69 percent of  
14 the respondent say they sell their music on-line, either  
15 on their own web site or via stores like Amazon or CD  
16 Baby.

17           Now, musicians are also very divided about  
18 file-sharing. There is no clear consensus. The Pugh  
19 Report found that 35 percent of musicians who responded,  
20 they agreed with the statement that file-sharing services  
21 are not bad for artists because they help promote and  
22 distribute their work.

23           Twenty-three percent agreed with the statement  
24 that file-sharing services are bad, because they allow  
25 people to copy an artist's work without permission or



1 payment. And then 35 percent of the artists who  
2 participated agreed with both statements.

3 Now, when you break it down, by musicians  
4 income and time, emerging artists are more likely to  
5 agree that file-sharing services are not bad, because  
6 they allow them to promote and distribute their works.

7 On the other hand, artists who make the  
8 majority of their income from being a musician or  
9 songwriter, were more likely to agree that file-sharing  
10 services are bad. Thirty-five percent opposed to 23  
11 percent.

12 So given these various factors, an emerging  
13 broadband marketplace, extensive consumer demand for  
14 digital distribution models, and an explosion of the  
15 amount of music release, the fundamental opportunity and  
16 challenges to facilitate the development of a legitimate  
17 digital music marketplace. And this marketplace is  
18 emerging.

19 As Sound Scan reported the first four months of  
20 2004, consumers purchased 35.3 million music downloads,  
21 and it's projected at least a hundred million will be  
22 sold in 2004. That's only about 1 percent of the  
23 recorded music market by the way.

24 So the question is, how do we manage this  
25 transition to a legitimate digital marketplace in a way

1 that benefits musicians and music fans.

2 Now, from our stand point there has been  
3 significant progress. In '95, Congress passed the  
4 Digital Performance Right and Sound Recordings Act, which  
5 granted performance rights for digital transmission of  
6 sound recordings, and led to the creation of  
7 SoundExchange.

8 SoundExchange has emerged as a respected,  
9 functioning collection and distribution agency that  
10 serves as a compliment to ASCAP and BMI. They paid out  
11 6.5 million dollars in royalties earlier this year, I  
12 believe. And since 2001, they've paid over \$22 million  
13 in royalties.

14 Now, we also must recognize music fans'  
15 excitement over new technology and models, including new  
16 satellite radio, distribution subscription services, like  
17 Rhapsody, EMusic and Napster; MusicBlogs, Ezines, the  
18 growth of Internet and web casting and digital download  
19 stores like iTunes.

20 This trend is a critical precursor. It  
21 demonstrates the consumers' willingness to use legitimate  
22 digital services. If we build it, they will come.

23 Now, the point is not that this industry is now  
24 perfect, or that we even see a solution. Rather we need  
25 to acknowledge the digital transition is complicated. It

1 includes multiple competing markets dependent on evolving  
2 technological innovation and regulatory policy decisions.

3 The future of music marketplace will be driven  
4 by consumer adoption of broadband to the home, which is  
5 an area full of regulatory and technological uncertainty  
6 of its own.

7 Spectrum policy, the transition to digital  
8 terrestrial radio. These will play a significant role  
9 determining how consumers are able to access digital  
10 content, and how performers will be compensated in the  
11 future.

12 Ideally, musicians and music fans will be  
13 central to determining the success of these new business  
14 models, consumer products and software applications.

15 The Future of Music Coalition has been really  
16 fortunate to work with well over a dozen different  
17 organizations that represent hundreds of thousands of  
18 musicians, song writers, retailers, promoters, community  
19 broadcasters and music fans.

20 Now, for these communities, the transition to a  
21 digital economy represents both real threats and real  
22 opportunities. Now, that being said, the core themes  
23 that we think cut across all aspects of the music  
24 community, and these are shared values that can serve us  
25 going forward.

1           One, whenever possible, artists must maintain  
2 control over copyright and career decisions. Two,  
3 artists must be able to compete fairly in the  
4 marketplace. They must be able to receive compensation  
5 for the work, and have access to consumers. And third,  
6 artists must be viewed by the policy making community as  
7 valued stake holders in these debates.

8           Now, as I mentioned before, there are many,  
9 many organizations with well reasoned, articulate  
10 positions on both the macro concerns and on specific  
11 micro issues, and I think you've heard from one or two of  
12 them over the last two days.

13           And our hope is that policy-makers across the  
14 board will grant at least as much weight to the view  
15 points of artists, songwriters, and the music community  
16 to those of the affected industries.

17           In the summer of 2000, The Future of Music  
18 Coalition said that the only antidote to an illegal  
19 Napster was a legal Napster. We meant it then, and we  
20 mean it today. In a world of breath-taking innovation,  
21 the focus cannot be on restricting technology, but  
22 rather, on building new consumer business models.

23           We also said that these technology debates are  
24 not black and white. They really rest mostly in the  
25 gray. The role of the music community is not to pick

1 sides, or even perceive that there are sides to pick.  
2 Rather, this is an opportunity for the music community to  
3 identify what is right with the historical models and  
4 attempt to place it in a digital context, where artists  
5 can control their work and receive fair compensation for  
6 their efforts, and music fans can have unprecedented  
7 access to music at a variety of price points, using a  
8 variety of products.

9           According to the Pugh Internet report, there  
10 are 32 million Americans who consider themselves artists,  
11 and there are more than three times as many who pursue  
12 some sort of artistic endeavors in their lives. The  
13 report also suggests that of them, 10 million Americans  
14 earn at least some money from their performance, songs,  
15 paintings, video, sculptures, photos, or creative  
16 writing.

17           Clearly, artists are economic actors in this  
18 policy debate, both as creators and consumers. We urge  
19 you to engage the music community and its advocates in  
20 upcoming discussions.

21           Again, I want to thank you for the opportunity  
22 to participate in this discussion, and I look forward to  
23 any questions that you may have. Thanks.

24           (Applause.)

25           MR. HADEISHI: As we mentioned at the start of

1 this panel, the 1:00 deadline is actually firm. I'm  
2 going to allow each panelist to briefly, and I'm talking  
3 briefly, clear up the record if they have anything to  
4 say.

5 Starting from my left, to the right.

6 MR. SHERMAN: Just one thing, to clarify  
7 something that Stan Liebowitz said. We don't claim that  
8 every download is a lost sale, and I don't think we have  
9 ever claimed that any of the copying technologies,  
10 because clearly it's not.

11 I guess most of my response would be to what  
12 Sam Yagan had to say. You know, he's talking about it's  
13 good that they're profit making and that the decision is  
14 ultimately the consumer's.

15 Unfortunately, you can make the same argument  
16 if you're an old-fashioned pirate and manufacturing  
17 counterfeit CDs and selling them on the street. So that  
18 argument really doesn't go that far.

19 I think ultimately this is about the artist,  
20 the creator having the choice about how they're going to  
21 promote their work. That decision shouldn't be made by  
22 some third party without their decision. They shouldn't  
23 be telling them, we know what's best for you; we're going  
24 to promote your work for you whether you want it or not.

25 And if P-to-P really does offer a sense of

1 community, and it may, it really may, then, Sam, and all  
2 the other P-to-Ps, you ought to be signing up with  
3 Snowcap or World, or one of the other organizations that  
4 offer a legitimate mechanism for taking advantage of the  
5 community aspect of P-to-P without the infringement.

6 MR. STRUMPF: I just wanted to thank the FTC  
7 for putting together this conference. I think it's  
8 exactly this kind of dialog based on facts, based on  
9 studies, that is necessary to decide where we take P-to-P  
10 from here, and I think this was -- I learned a lot.

11 This was a great conference and it's this type  
12 of information dissemination that's more important than  
13 the hype that we usually get through the media.

14 MR. LIEBOWITZ: And I don't have much to say.  
15 On the point Cary just brought up. I wasn't trying to  
16 say that it's something that I've heard recently.

17 My memory, which may be wrong on this, was that  
18 Alan Greenspan, when he testified about audio taping in  
19 the mid '80s, actually said that for each blank video --  
20 audio tape represented a lost sale of a --

21 MR. SHERMAN: No, he didn't. He didn't. It  
22 was actually based on a survey. There was a percentage  
23 of it

24 MR. LIEBOWITZ: Okay. And I take it back.

25 MR. POTTER: I never had Alan Greenspan on my

1 payroll.

2 (Laughter.)

3 MR. POTTER: I just -- this wild ride is going  
4 to continue for a while, and just buckle up. At the end  
5 of the day though, it's all about consumers and it's all  
6 about creators, and the rest of us just better add value  
7 to the system, or get out of the way.

8 (Laughter.)

9 MR. OTTOLENGHI: I just want to thank the,  
10 again, FTC, and then advocate to everyone here on the  
11 panel that if you are interested in looking at a  
12 reasonable business model that's legitimate and that has  
13 worked in P-to-P, please speak with us.

14 You mentioned SnowCap, Mr. Sherman, but really,  
15 we're doing the same sort of thing. We're already out  
16 there. I know the SnowCap people very well. We've never  
17 been a member of doing anything other than legitimate  
18 business.

19 Please, I encourage you to work with us in the  
20 DCIA for legitimate distribution and the members of your  
21 organization I would ask in front of this audience, that  
22 you please affirm commitment about it.

23 MR. SHERMAN: Well, no, we heard about the  
24 stuff that you've been talking about, and we've been  
25 meeting with Martin, and we're very encouraged by that.



1 MR. OTTOLENGHI: Okay. Well, I'll hope that  
2 you will encourage your members to work with us directly,  
3 and, again, Sam, thank you for your work with us.

4 Woodie, if you have a chance, we would like to  
5 talk with you and Michael as well.

6 (Laughter.)

7 MR. YAGAN: Thanks, again, to the FTC for  
8 hosting this panel. I guess, Mr. Sherman, I was hoping  
9 you would comment on my invitation to join me in calling  
10 for an impartial analysis of whether this filtering  
11 technology actually works by a bunch of impartial  
12 scientists, not funded by lobbyists from either side.

13 MR. SHERMAN: You know, maybe it's just that  
14 I'm from Washington, but the oldest thing in the book,  
15 when you want to delay something, you say "we'll do a  
16 study." We have filtering, actually, in the marketplace  
17 right now. Why don't you just try one of those? I'm  
18 sure that any of those filtering companies would be happy  
19 to put the filter into your client, and test it out with  
20 you in any way that you want.

21 MR. YAGAN: And you can understand the concern  
22 by technology providers who want to know whether this is  
23 actually scalable and functional before we put that into  
24 our software.

25 MR. SHERMAN: I'm sure we could agree on a way

1 to test it.

2 MR. YAGAN: We should talk about that, then.

3 The second issue -- again, on filtering, just  
4 in closing. Like I said, this is an issue for the  
5 consumer to decide. So I would be curious if you have  
6 any data that the consumers would desire, a SnowCap  
7 enabled peer-to-peer application?

8 Because, if so, I think that would be the  
9 compelling argument to say this is what consumers want,  
10 and with our job as software designers, to give those  
11 consumers what they want.

12 So if you have that evidence, I would also be  
13 happy to work on that.

14 MR. SHERMAN: Nobody asked for any evidence  
15 whether the consumers would want peer-to-peer, either.  
16 You just put it in the marketplace, and lo and behold,  
17 people wanted free stuff.

18 Now there's a concern that if you filter out  
19 the stuff that they want, they may not be on P-to-P  
20 anymore. I can't tell you what the marketplace will  
21 want, but if a P-to-P is a real value, if it really is an  
22 asset, then by all means go legitimate and offer the  
23 content at a price, negotiate the price in any way you  
24 want, but work it out so that people just aren't able to  
25 take the stuff for free.

1 MR. YAGAN: And I respect your position on  
2 that. I think the concern would be that if -- people  
3 like me actually come to these events and want to engage  
4 in this dialog. And there are people, like  
5 EarthStationV, who are incorporated in the -- refugee  
6 camp, who really don't -- who really don't have any  
7 interest in being here.

8 So I guess the concern would be -- you know,  
9 without that evidence that this would be a consumer  
10 embraced concept, the risk to both of us, honestly, is  
11 that -- as much as you described my business as  
12 illegitimate, there are far more illegitimate businesses  
13 that I compete with.

14 And so the concern would be --

15 MR. POTTER: Excuses aren't affirmative  
16 defense?

17 MR. YAGAN: No, no. What I'm saying is aren't  
18 we both worse off if everybody is using EarthStationV?  
19 And shouldn't we really work to find out what consumers  
20 want first, before we just roll the dice and see what  
21 happens?

22 MR. POTTER: But the marketplace has rolled the  
23 dice. Go roll the dice in the marketplace and the  
24 consumers will tell you if you win or lose.

25 MR. YAGAN: That should be up to each

1 individual peer-to-peer application, software  
2 application, to say, yes, I want to take this risk for  
3 the reward.

4 And the question is what is the reward that the  
5 market is going to offer for taking that risk?

6 MR. POTTER: For some people, it might be jail.

7 MR. NEWTON: One other quick note, to plug  
8 Stephen Foster again.

9 (Laughter.)

10 MR. NEWTON: And I'm serious now, the album --  
11 we were all invited to -- I was fortunate to be the  
12 producer on one of the songs, the old Way Down Upon the  
13 Swanee River song. Old Folks at Home. And David Ball  
14 was the singer, and I got to sing background on it.

15 They asked us to be involved with a group of  
16 people. We did this all at our own expense. I called up  
17 my favorite musicians. They played for free. All the  
18 proceeds from this record go to Roots Music in the  
19 schools, and what a great way to teach that.

20 But the great news is, it's nominated for album  
21 of the year, contemporary folk category for a Grammy. So  
22 you might see us on stage. Who knows.

23 And it prompted me to read a book by the guy  
24 that wrote the liner notes; Ken Emmerson wrote a book  
25 called DooDa, and I'm in the middle of the book, and it's

1 fascinating. I highly recommend it. It talks about the  
2 melding of black and white and folk music, and it's  
3 really amazing. And again, thanks for inviting me here,  
4 and I enjoyed it.

5 MR. BESEN: I'll just say a couple of notes. I  
6 mean, first, thank you so much to the FTC for holding  
7 this forum, and thanks for inviting us. I want to, you  
8 know, basically mention again not only is Wood's  
9 association an organization of great resource, but there  
10 are many, many others out there, AFM, Recording Artists  
11 Coalition, The Recording Academy, just plain folks, you  
12 know, half a dozen others, who all are very interested  
13 and engaged and have a lot to say on this issue. So I  
14 hope that as these conversations continue, that they're  
15 brought into the discussion.

16 And I just also want to say I have -- maybe  
17 it's the holidays, but I did get the sense that there is  
18 progress being made on all these issues over the years,  
19 and I think everybody certainly at this table has got a  
20 lot to do with it, and I appreciate -- I think we  
21 appreciate that there really is a lot of positive  
22 progress.

23 So you know, good work, everybody.

24 MR. HADEISHI: Okay. Thank you all, to the  
25 panelists. We need to move on to closing remarks. If

1 the panelists could stay seated, this probably would be  
2 easiest.

3 I apologize to those of you who had questions.  
4 We just, unfortunately, don't have the time for them.  
5 What we're going to do now, is move to closing remarks  
6 from Susan Creighton, who is the Director of the FTC's  
7 Bureau of Competition.

8 For those of you who waited in line, I'm very  
9 sorry, because I know you've been standing there a long  
10 time. I would encourage you to submit, you know,  
11 something in writing to us so that we can consider the  
12 thoughts.

13 A PARTICIPANT: It seems rather fruitless to  
14 have brought together a panel of this caliber to address  
15 the effects on competition, the compensation system, and  
16 not to allow a few questions from the audience.

17 MR. HADEISHI: I'm sorry, we simply do not have  
18 time, because we have to turn the room over to another  
19 group. And so we will move on to final remarks from  
20 Director Susan Creighton.

21 MS. CREIGHTON: We've now reached the end of  
22 this important, productive, and very timely workshop. I  
23 would like to thank all the panelists who volunteered  
24 their time and expertise to discuss the varied and  
25 complex issues related to P-to-P file-sharing.

1 I would also like to thank those are not  
2 panelists, but provided public comments, or posed  
3 questions to direct our discussions and build a rich and  
4 detailed record.

5 The record will remain open for public comments  
6 until January 18, 2005; and so I would encourage all  
7 those who didn't have a chance to ask questions or to  
8 pose comments here during the course of the hearing to  
9 please submit your comments in response to what you have  
10 heard the past two days.

11 The instructions for submitting a comment can  
12 be found on the FTC's P-to-P Workshop web page.

13 Just in closing, just a very few comments.  
14 First, I want to particularly thank Commissioner Harbour,  
15 who is right here, for her leadership in promoting this  
16 workshop. Her efforts have been, and will continue to be  
17 critically important to the Commission in assessing what  
18 the workshop has taught us.

19 And last, but certainly not least, I would like  
20 to thank the staff from each of the bureaus for their  
21 fine work in organizing the workshop.

22 (Applause.)

23 MS. CREIGHTON: The panels this morning were a  
24 spirited and informative discussion about the impact of  
25 P-to-P file-sharing on industries that rely heavily on

1 intellectual property rights.

2           Discussions this morning have helped us better  
3 to understand the importance of reaching the proper  
4 balance between the legitimate intellectual property  
5 interests of creative people, and the interest that  
6 others, particularly consumers, have in maximizing the  
7 benefits that the tools of expanding technology provide.

8           Among other things, we have learned that  
9 business models that worked successfully in the past may  
10 have to be changed -- not merely to accommodate P-to-P  
11 file-sharing technology, but also to incorporate that  
12 technology.

13           The potential benefits and drawbacks of  
14 filtering, digital rights management, and collective  
15 licensing schemes, among other technological and legal  
16 tools, have been fiercely and energetically debated by  
17 leading experts here over the last two days.

18           One thing that is already clear, however, as we  
19 learned yesterday and today, this technology clearly  
20 holds immense promise significantly to increase  
21 efficiency and to expand into ever-widening new  
22 applications.

23           Therefore, although there are some legislative  
24 efforts currently under way to address the issues and  
25 concerns created by the emergence and expanding use of



1 P-to-P file-sharing software, it will be very important  
2 for policy makers and legislatures to proceed with  
3 caution, less we inadvertently put roadblocks in the way  
4 of P-to-P's potential.

5 We must take care so as not to attempt to solve  
6 the problems of the present by sacrificing potentially  
7 dramatic future longer term gains to consumers and our  
8 economy.

9 This final note, let me thank you again all for  
10 coming to the workshop. For sticking here to the very  
11 end. Please keep an eye on our web site for any  
12 additional public comments that will be posted, and for  
13 information about when the workshop record will be made  
14 available to the public.

15 Thank you all, and have a good afternoon.

16 (Applause.)

17 (Whereupon, at 1:14 p.m., the workshop was  
18 concluded.)

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CERTIFICATION OF REPORTER

CASE TITLE: PEER-TO-PEER FILE-SHARING TECHNOLOGY  
HEARING DATE: DECEMBER 16, 2004

I hereby certify that the transcript contained herein is a full and accurate transcript of the tapes transcribed by me on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: MAY 24, 2004

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LISA SIRARD

CERTIFICATION OF PROOFREADER

I hereby certify that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

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DIANE QUADE