

FEDERAL TRADE COMMISSION

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FEDERAL TRADE COMMISSION

FEDERAL TRADE COMMISSION)
WORKSHOP ON:) Matter No.
HOW WILL JOURNALISM SURVIVE) P091200
THE INTERNET AGE)
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TUESDAY, MARCH 9, 2010

Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

The above-entitled workshop commenced,
pursuant to notice, at 9:35 a.m.

P R O C E E D I N G S

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2
3 MS. DESANTI: Good morning. Could you please
4 take your seats? My name is Susan DeSanti. I'm the
5 Director of Policy Planning at the Federal Trade
6 Commission, and my staff and I have organized this
7 workshop. I want to welcome you. This is the second
8 FTC two-day workshop on the Future of Journalism.

9 Now I'm going to start with the boring, required
10 security reading, so if you have to snooze for a couple
11 of minutes, this would be the time to do it. Anyone who
12 leaves the building without an FTC badge will be
13 required to go through the magnetometer and x-ray
14 machine prior to reentry into the conference center.

15 In the event of an emergency, fire or
16 evacuation, the alarms will sound. At that time, please
17 gather your personal belongings, if the situation
18 permits, and leave the building in an orderly fashion.
19 Once outside of the building, orient yourself to the
20 corner of 7th street and Constitution Avenue, Northwest,
21 where you will enter the National Gallery of Art. That
22 is our rallying point. Everyone will rally by floor, so
23 please stay together. You will need to check in with
24 the conference meeting coordinator.

25 In the event that it is safer to remain inside,

1 known as shelter in place to those of us in the
2 government, you will be advised where you should report
3 to while inside the building. Information and updates
4 will be distributed via the Public Address System, and
5 please remain with the conference meeting coordinator.

6 Finally, if you spot suspicious activity, please
7 alert the conference meeting coordinator and/or security
8 staff. Okay. Duty done. Now we can get down to
9 business.

10 Now, as most of you know, we held a two-day
11 workshop on December 1st and 2nd, 2009, to explore the
12 economics of journalism in print and online, how the
13 changes in advertising are affecting revenues for news
14 organizations, and the ongoing creation of new types of
15 news organizations, most on a smaller scale than
16 traditional newspapers. That workshop confirmed the
17 significant transformation that journalism is undergoing
18 as a result of the digital age.

19 Now, additional work published since that
20 workshop has underscored the transformation. A new
21 report from the Pew Research Center titled
22 "Understanding the Participatory News Consumer"
23 included this key finding: The Internet has surpassed
24 newspapers and radio in popularity as a news platform on
25 a typical day and now ranks just behind TV. So TV

1 remains the most popular source of news, but the
2 Internet is now the second most popular, with newspapers
3 as the third.

4 At the same time, another recent Pew study
5 suggested that newspapers are still the primary source
6 of original news stories. That study examined all of
7 the outlets that produced local news in Baltimore,
8 Maryland, for one week, surveying their output, and then
9 taking a closer look at the six major narratives that
10 emerged during that week.

11 The study found that much of the news people
12 receive contains no original reporting. Eight out of
13 ten stories that were studied simply repeated or
14 repackaged previously published information. Of the
15 stories that did contain new information, nearly all, 95
16 percent, came from traditional media, most of them
17 newspapers. These newspapers stories then tended to set
18 the narrative agenda for most other media outlets.

19 So now we begin two days of workshops that are
20 intended to illuminate some of the policy proposals that
21 have been made to help ensure that such original news
22 stories continue to be produced.

23 We're going to begin today with presentations on
24 the economics of newspapers, both online and offline,
25 followed by a presentation on the state of advertising.

1 Then we will examine copyright issues. Although
2 copyright law provides important protection to news
3 stories, new questions have arisen about the extent to
4 which aggregators' use of the original news stories of
5 others complies with copyright law and whether
6 modifications to that law might be desirable or
7 feasible.

8 In the afternoon, we begin with presentations on
9 ways to reduce the costs of journalism, and then we will
10 explore corporate and tax solutions that might be
11 applicable to faltering newspaper businesses. Tomorrow
12 we will discuss additional topics.

13 We're looking forward to learning from all of
14 our distinguished speakers and panelists, and we thank
15 all of you for joining us. Let me note that all of my
16 introductions of the panelists will be short because
17 otherwise we could spend the whole two days here just
18 reporting on all of their accomplishments and
19 distinctions. You can find all of those in the
20 biographies that are provided, and trust me, they are
21 impressive.

22 Now, we're going to begin with Dr. Hal Varian,
23 who is the chief economist at Google and also holds
24 academic appointments at the University of California,
25 Berkeley, in three departments: Business, economics,

1 and information management. Dr. Varian has been
2 involved in many aspects of Google's business, including
3 auction design, econometric analysis, finance, corporate
4 strategy and public policy. He will address newspaper
5 economics online and offline.

6 Hal?

7 DR. VARIAN: Thank you. Well, thank you very
8 much for that kind introduction. I'm quite happy to be
9 here. As you heard, I'm going to talk about online and
10 offline economics of newspapers, and basically this is
11 going to be mostly a fact based presentation, looking at
12 revenue and costs, advertising, level change in
13 composition, and so on, and most of the talk is based on
14 publicly available data from the Newspaper Association
15 of America, who's put up a very nice website on trends
16 and numbers, the U.S. Statistical Abstract, The Pew
17 Foundation, and some other sources. There will be a
18 little bit of Google data that has also emerged with
19 this report.

20 So I want to start off with a little overview of
21 what revenues and costs look like for newspapers, and
22 basically the bottom line here is 80 percent of the
23 revenue roughly comes from advertising, 20 percent from
24 sales, and if you break down the cost side of
25 newspapers, it turns out that about 50 percent of the

1 costs are production and distribution; that is, the
2 physical production and distribution of the newspaper.

3 Obviously, it would be very attractive if you
4 could reduce your costs by 50 percent for any business,
5 so the promise of the Internet is to reduce costs, and I
6 understand we're going to hear much more detail about
7 that this afternoon.

8 If you look at ad spend by medium in the United
9 States, I pulled this data from the U.S. Statistical
10 Abstract, of course the big gorilla in the room is TV,
11 where if you look at broadcast and cable TV, you've got
12 by far the largest expenditure on advertising on those
13 two media. Surprising enough, the next biggest thing is
14 direct mail, and then after direct mail comes the
15 newspapers.

16 If you look at how things have changed over the
17 years, broadcast TV has gone down a little bit. Cable
18 TV has grown by quite a bit, almost a factor of three.
19 The Internet has grown from nothing in 1995 to about 5
20 percent of ad expenditures in 2008, and newspapers, as
21 you can see, have contracted from about 23 percent down
22 to maybe 13 percent or so, so the big changes are
23 apparent in this diagram, and I guess the next talk is
24 going to be perhaps more up-to-date figures on the
25 advertising business of newspapers.

1 Newspapers, of course, are still about three
2 times as large in terms of ad revenue as the Internet,
3 so they're still quite a major force in the advertising
4 world, and this is another chart showing pretty much the
5 same thing. If you look at newspapers, that's the blue
6 line, they've been going down since basically 1950 in
7 terms of media share.

8 If you look at the yellow line, that's TV and
9 cable. That's been going up quite dramatically over the
10 same period, and way down there on the bottom right hand
11 corner, that light blue line, is the Internet, which
12 came from pretty much nothing up until maybe the late
13 1990s started to become a force in advertising. Other
14 media have stayed more or less the same.

15 Now, this is a plot of GDP, which I just put
16 there to have a general measure of economic activity,
17 and newspaper ad revenue, and I've adjusted it by the
18 Consumer Price Index, so you can see what the changes
19 have been in real term, so basically I have real GDP and
20 real newspaper ad revenue, and as you can see, its
21 pretty much peaked back in the late '80s, since then was
22 more or less constant up until the last couple years
23 where it took a big drop down.

24 By the way, the vertical gray bars are
25 recessions. One thing to note is that typically during

1 recessions, advertising expenditure is quite sensitive
2 to cyclical conditions, so you'll see both GDP typically
3 dropping and advertising expenditures dropping as well,
4 last couple of years have been dropping outside, even
5 more than the economy would indicate, and we'll see an
6 echo of that in one of the later slides. An important
7 point is that newspaper ad revenue pretty much maxed out
8 way before the Internet came on the scene.

9 This is a picture of what ad revenue looks like
10 by type, again measured in constant dollars, so
11 typically it's broken down into four different
12 categories: Retail, which would tend to be local
13 stores; national, which would be national brand
14 advertising; classified, the blue segment there; and
15 then online is that tiny little green segment that kind
16 of popped up a few years ago.

17 So you can see what's been going on is retail
18 advertising has actually been growing over this period.
19 The brand advertising has been contracting, and
20 classified advertising stayed pretty much the same up
21 until the last few years, at which point it dropped
22 fairly precipitously, and this is the same chart, only
23 measured in shares, so you can see the share issue a lot
24 more clearly. I think the important point to note here
25 is the online ad revenue, as of 2008 at least, is

1 substantially less than 5 percent.

2 What about circulation? Well, if you look at
3 circulation, that chart in the upper left-hand corner,
4 the daily circulation stayed constant for a long period
5 of time and dropped in the last couple of years, but, of
6 course, it's a little bit misleading just to look at
7 total circulation. What you're most interested in most
8 likely is circulation per household, so if you look at
9 paid circulation per person over on the right, you can
10 see it was declining since the '60s in pretty much a
11 steady manner.

12 The interesting thing is if you look at ad
13 revenue per reader or ad revenue per circulation, it
14 actually was increasing since the late '60s, with a few
15 ups and downs during these recessionary periods and so
16 on, but by and large increasing up until very recently,
17 the last few years.

18 The ad revenue per circulation has been going
19 up, even though ad revenue is going down, because the
20 circulation has been going down so much, so it's the
21 denominator that's been causing this effect.

22 Here's another chart just showing circulation,
23 which again has been remarkably constant between say 55
24 and 60 million copies, and here's a chart of circulation
25 per household, which has also been pretty stable in

1 terms of its decline. Back in 1947, we were seeing a
2 little over one newspaper per household, which I presume
3 was morning and evening editions in many cases, but
4 that's gone down to something like .4 newspapers per
5 household in today's world.

6 This is the chart that we just heard Susan refer
7 to, that now the Internet has surpassed physical
8 newspapers as the popular way of accessing information.
9 I would say television has got a pretty substantial lead
10 on both of them, and of course most of the Internet
11 access is access to newspaper sites, although they
12 aren't, of course, the physical paper.

13 In that same report, there were some interesting
14 trends about getting news by phone. 26 percent of all
15 Americans said that they actually access news on their
16 phones, and 43 percent of those under 50, so this is yet
17 another medium by which people can access news, but in
18 many cases, given the interfaces available, people are
19 looking at weather, at current events because reading
20 in-depth on your phone may be somewhat inconvenient.

21 I thought one of the more fascinating numbers
22 that came out of Pew report was that 80 percent of
23 people get news from emailed links. That's actually one
24 of the most popular distribution mechanisms now, because
25 if you see an interesting story, you send it to your

1 friends, and if you go look at newspaper websites, you
2 see that most emailed stories, many of those are
3 accessed on people's computers and now increasingly on
4 the hand-held devices.

5 Of course, we shouldn't think of just a single
6 medium per person. About half the population surveyed
7 said they use four to six different media for accessing
8 news, so it's important to distinguish in these
9 discussions between newspapers, traditionally considered
10 as the physical newspaper, and of course all the other
11 ways you can access news: On T.V., on your phone, on
12 your computer, your laptop, et cetera.

13 Now, if you add it all up and you look at the
14 difference between physical newspaper reading and online
15 newspaper reading, you get this kind of amazing
16 statistic. This is due to Martin Langeveld at Harvard.
17 Only about 3 percent of the total news page views come
18 on the computer. Most of it comes through looking at
19 physical newspapers, and you get very nice numbers by
20 looking at the web data.

21 This is data from the Newspaper Association of
22 America, that people are spending about 38 minutes per
23 month on online news, which works out to about 70
24 seconds a day, whereas a person who reads a physical
25 newspaper tends to spend about 25 minutes a day.

1 There's also some time use studies that back these
2 numbers up.

3 So even though accessing news online is a very
4 popular thing to do, it's actually the case that people
5 are not spending nearly as much time on the newspaper
6 online as those people are who are reading the physical
7 newspaper. Of course, they're different populations, so
8 you have to compare these carefully, but roughly
9 speaking, about 3 percent of either page views or time
10 accessing online news -- sorry, 3 percent of the total
11 access to newspapers is done online.

12 On the other hand, it's accessed quite often,
13 this is some data from the U.S. Statistical Abstract,
14 also it came from Pew, that roughly 40 percent of adult
15 Internet users say that they accessed news yesterday,
16 and in fact, if you look at those with household incomes
17 of 75,000 or more, it's about 53 percent, so it's very
18 popular to access that online news. It's just that
19 people aren't spending a great amount of time on it, at
20 least compared to those people who are reading the
21 physical newspaper.

22 If you look, for example, at total number of
23 hours per year where people are accessing newspapers or
24 reading newspapers, it's about, let's see in 2008, 168
25 hours per year, so roughly it works out to 25 minutes a

1 day or so in terms of physical newspaper consumption,
2 and that's on the same order of magnitude as the time
3 that people spend on the Internet.

4 News is the third most popular activity online.
5 Sending or reading email, using a search engine, getting
6 news online, those are again the three top things that
7 people do on the Internet, but they're spending a lot
8 more time, for example, reading email than they are
9 looking at the online news.

10 Now, this is a little bit of a paradox, so let
11 me just sort of stop for a minute of showing you the
12 charts. The paradox is it's popular to access news
13 online. Lots of people access news online, but they
14 don't seem to spend very much time doing it, so why is
15 that? That's a little bit of a mystery, at least how
16 much time they do it compared to physically reading the
17 newspaper.

18 So I pulled some Google data, and I looked at
19 the time use pattern of access to Google news. So what
20 you have down there on the bottom are the hours over a
21 couple weeks. The two little small bumps are the
22 weekend access, and the five bumps between them are the
23 daily access.

24 So the red line is search activities, so this is
25 how many people are searching Google for things, and the

1 blue line is the news activity, so I plotted both these
2 charts and the area underneath each graph is normalized
3 to be one, so it's measured in percentage terms.

4 So what's the first thing you see? Well, the
5 blue line is a lot further up than the red line, so what
6 that says is that people are accessing the news during
7 the day a lot more frequently than they're doing
8 searches, and if you go over and look at the weekend,
9 you can see that the searches dramatically exceed the
10 news, so people are doing searches a lot more on the
11 weekend than they are accessing the news, and what that
12 suggests to me is, well, people are accessing online
13 news a lot during business hours.

14 So now it's not so surprising that they're not
15 spending a whole lot of time on it because offline news
16 reading, that's a leisure time activity. You do it over
17 your cup of coffee or you do it in the evening maybe,
18 whereas online news reading, that's a labor time
19 activity. That's something where people are snatching a
20 few minutes out of the day to go check the sports scores
21 or the headlines or something of that sort.

22 So it's absolutely true that people are spending
23 much less time looking at online news than they've
24 traditionally spent reading offline news because they're
25 doing it mostly during working hours, much less during

1 leisure hours. During leisure hours, well, you might
2 sit and watch TV. As a matter of fact, it would be a
3 very common thing to do.

4 So the challenge I think that's facing the
5 newspaper industry is to try to turn that online news
6 access, which is much more cost effective and a much
7 more attractive way to get your broad audience, and to
8 increase involvement with the news by turning it back
9 into a leisure time activity.

10 Now, if you look at the value of clicks sent to
11 newspapers, according to comScore, search engines drive
12 about 35 to 40 percent of the traffic to major U.S. news
13 sites, and you assume that that monetizes about as well
14 as other traffic. Well, then that means that search
15 engines are driving about 35 to 40 percent of traffic,
16 of revenue to online news sites. That's a pretty
17 substantial amount.

18 However, I have to remind you that the online
19 news revenue is only about 5 percent of the total, so
20 even though they're driving a substantial fraction of
21 the online revenue, that's still a relatively small
22 amount of the total revenue.

23 Now, one thing that's interesting to do is that
24 if you look at a search click that goes to a newspaper
25 site, the newspaper is sent the query -- or any site,

1 not just the newspaper site. The site is sent the query
2 that generated that search click, and that means that
3 the site that receives that search click can then direct
4 the user to the appropriate section of the site.

5 So you can take those queries that people are
6 issuing when they click on news sites and ask: What are
7 the categories? What are people looking for when they
8 go to these online news sites? I've done that. It
9 turns out that the kinds of things that people are
10 looking for when they're going to these online news
11 sites are sports, news and current events, and local.
12 Those are the top level categories that we use at Google
13 to categorize search clicks.

14 There's relatively fewer news clicks
15 proportionately than search clicks in the area of
16 travel, health, shopping and so on, and there's roughly
17 about the same in entertainment and computers and
18 electronics, so what I'm doing is I'm comparing searches
19 that go to newspapers, to just searches in general, that
20 go to sites that aren't specifically classified as
21 newspapers, and here when I say newspapers, I mean sites
22 that are indexed by Google news.

23 Now, the bad thing or maybe not the bad thing,
24 just the fact, is that if you look at the money in
25 online advertising, the money is in categories like

1 travel, health, shopping and consumer and electronics,
2 but if you look at the revenue that's going to
3 newspapers, that's in sports, news and current events,
4 and local, and believe me, it's very, very hard to
5 monetize those categories because there just isn't as
6 much consumer dollars spent in those areas than there
7 are in areas like travel, health, and shopping.

8 So the news, narrowly defined, is pretty hard to
9 monetize, despite the fact that it's popular and
10 frequently accessed. There's a relatively low level of
11 involvement because of the time constraints that people
12 face, and it's typically not a highly commercial
13 activity.

14 In fact, newspapers have never made money from
15 news. If you go look at where the revenue came from,
16 they made money from the business page, the automotive
17 page, home and garden, travel, real estate, technology,
18 all those sections of the newspapers that you wouldn't
19 consider as being raw news, not the front page.

20 Why? Because you can contextually target ads.
21 It's not surprising that people who read the automotive
22 page are interested in buying cars or people who look at
23 the travel section might be interested in taking trips,
24 so you see contextually targeted ads in the physical
25 newspaper that are tied to those sections, and then it's

1 the revenue generated from those sections which is used
2 to cross subsidize the actual production of news.

3 What's happened is this has been a problem in
4 disintermediation that now people can go directly to
5 finance sites, to auto sites, to consumer electronics
6 and books, to travel sites, real estate sites and so on,
7 so as people go directly to seeking those specific
8 sources of information, they tend to bypass the
9 traditional sections of the newspaper, and so the cross
10 subsidization model, which has worked for so many years,
11 has not really worked now.

12 It's very, very hard to do contextual targeting
13 for pure news. If you're reading the travel section and
14 then you see a story about Hawaii, you wouldn't be
15 surprised to see ads for trips to Hawaii next to that
16 story, but if you read the news section and you see
17 bombing in Baghdad, you're not likely to see travel ads
18 or anything else that's particularly relevant to that
19 story. So it's very, very difficult to do the same kind
20 of cross subsidization that we've seen work in the past.

21 In fact, if you go look at advertising verticals
22 for newspapers, you can see that about 20 percent has
23 been general merchandise, 14 percent financial. That
24 would tend to be in the business section of the paper,
25 home supplies, furniture and so on, so you look at the

1 breakdown of where the money's coming from, and it tends
2 to be somewhat different than the kind of things that
3 people are making money on on search engines and general
4 Internet advertising.

5 Now, of course all this doesn't mean that
6 newspapers aren't valuable. We heard earlier, and I
7 would absolutely second that, it's critical both from
8 individuals' and from the societal point of view, people
9 find it valuable because people are going to look at
10 news online. We saw that half the Internet users read
11 news online at some time or another. They just don't
12 spend a whole lot of time on it.

13 Now, you've seen this big debate about whether
14 you can charge for news and replace the advertising
15 model. My view is, yes. I mean, you should try for
16 sure, but there is this difficulty that you run into
17 when you start thinking about the economics of it
18 because you can really only charge for things if they're
19 differentiated. If there are a lot of close substitutes
20 for a product, it's very hard to charge for it, and you
21 have this problem with what economists call Bertrand
22 competition: If one seller sets a price here, the other
23 seller could undercut him a little bit, get the market
24 and so on. You get this kind of competing down to the
25 lowest common denominator, so you really have to have

1 news that's highly differentiated in order to support a
2 charging model.

3 So at one time I thought, well, local news,
4 that's highly differentiated, local football scores and
5 things like that, but then I realized that if all the
6 moms and dads are sitting in the audience on Twitter
7 with their mobile phones, maybe that news isn't so
8 highly differentiated after all.

9 There's also issues of specialized industry
10 content or points of view or opinions or analyses that
11 can't easily be imitated or also a case where you could
12 differentiate news, so I'm agnostic on this question of
13 whether the charging will work. I think it's certainly
14 worth a try, but of course you can only charge for
15 something that's going to be unique content. It's very
16 hard to charge for, let's say, the weather or something
17 of that sort.

18 So in summary, when you go through and look at
19 all this, newspaper ad revenue has been pretty much
20 constant inflation adjusted dollars. The circulation
21 per capita is going down since 1947. The really big
22 increase in advertising revenue has come from cable TV,
23 and that was way before the Internet.

24 You do have this problem with online news, that
25 people are using it differently than they've used

1 offline news. They tend to access it more episodically,
2 and the challenge that newspapers face is how they can
3 use that to -- I mean, how they can turn that sort of
4 brief access to the news into the kind of deeper
5 involvement that you would like to have.

6 Well, what you need, and maybe everybody has
7 said that, it's not news, is engagement. You need to
8 increase people's engagement with news, and things
9 newspaper should do is experiment, experiment,
10 experiment, so Google has been working on doing some of
11 these experimentations.

12 I think a promising avenue is to try to link
13 news access during the day so that you move this rather
14 brief occasional access to stories, to a much bigger
15 engagement, partially by shifting some of that access
16 into leisure time as it traditionally was used, so we've
17 done things like living stories, where we work with
18 major newspapers to try to string together all the items
19 about a particular story as the news developed through
20 the day.

21 We got this capability called starred stories
22 where you can look at a story and star it, and then you
23 can follow what happens in that story, maybe look at it
24 later when you have some free time, fast flip and other
25 things like that.

1 I'm a big fan of the new devices. I think that
2 things like the iPad or the Kindle and this whole group
3 of tablet computing is going to potentially make a big
4 difference because it gives you a completely different
5 ergonomics for accessing the news. If people are
6 accessing online news at their work station or their
7 computer or their laptop during the day and they have a
8 lot of things going on, when you come home, probably you
9 don't want to go sit in front of your laptop or your
10 work station at home to do the same thing. What you
11 might want to do is sit in your easy chair and look at
12 your tablet where you can follow some of the stories
13 that you might have accessed originally at work.

14 Of course, this isn't going to be a flat textual
15 description. There's going to be multi media in those
16 devices, and so what I believe you will see is a merger
17 of the TV, magazine, radio and newspaper experience.
18 You will have a device which will access all those
19 different medias, give you a potentially deeper
20 involvement of the news, because what happens with TV is
21 you get this emotional experience from the visual side,
22 but in many cases, it's frustrating because you can't go
23 deeper into the story.

24 In the newspaper, a physical newspaper with
25 textual material, you can go much deeper into the story,

1 but maybe you don't have the same emotional involvement.
2 If we can get them both together, then potentially you
3 can have a really positive, interesting and worthwhile
4 experience. So I would like to see this area develop,
5 and we're doing what we can to help that happen.

6 Finally, the last point is newspapers should
7 better exploit the information they have. In many
8 cases, the newspaper website is seen as something that's
9 for the techies or the person who's managing the web log
10 is doing it just to look at how performance is working.
11 There's hugely valuable information in those web logs,
12 both from an editorial point of view and from a
13 marketing point of view, and there's lots of interesting
14 things that you can do when you understand why people
15 are coming to your site, where they're spending the most
16 time, what they're coming back to.

17 It's just extremely valuable information. I
18 think newspapers can spend more time on analyzing that
19 information and end up with better ad effectiveness
20 measuring, better contextual targeting and better
21 editorial targeting.

22 So I think I'll end there, and thank you very
23 much for your attention.

24 (Applause.)

25 MS. DESANTI: Thank you very much, Hal. Well,

1 those economists who are running out of the room who
2 just came for Hal, you're missing out totally by not
3 staying around for Bob Garfield, and now, as they say,
4 for something completely different.

5 Now we're going to hear from Bob Garfield, who
6 is co-host of National Public Radio's On the Media
7 program and a columnist, critic, essayist, pundit,
8 international lecturer and inveterate broadcaster. He
9 is the author of two books, "The Chaos Scenario" and a
10 collection of his work titled "Waking Up Screaming from
11 the American Dream," and so I am quite sure that Bob
12 will wake us up.

13 MR. GARFIELD: Thank you, Susan, ladies and
14 gentlemen, parents, teachers, boys and girls.

15 My presentation will indeed be a little
16 different than Hal's because Hal knows things like data
17 and facts and stuff. How that must feel.

18 Anyway, for reasons that will soon enough be
19 obvious, I want to begin this morning with my favorite
20 subject in the whole wide world, me. Just by way of
21 introduction, I'm Bob, Bob Garfield, James John, and to
22 the far right, may I call your attention to the bain of
23 my frickin existence? He is filthy rich and globally
24 famous, despite not even actually existing. I, on the
25 other hand, probably do exist and have spent 35 years

1 pounding boulders with a journalistic sledge hammer,
2 only to be extremely not rich and famous on about this
3 level (indicating).

4 All right. That's just mean, but you take my
5 point. I ask you to listen to me today, not because I'm
6 some sort of a big kanacker. Listen to me, please,
7 because of that. That is right. I am fairly useful,
8 but largely obsoleted by technology. In a microwave
9 world, there's still a market for toaster ovens, but
10 it's nothing like what it once was, and it is shrinking
11 all the time because, ladies and gentlemen, some things
12 just go away.

13 Let me go back. I don't know how to go back.
14 For those of you under 50, that thing I just showed you
15 was a fondue pot, very, very big at about the time that
16 Kennedy was shot. For those of you under 30, Kennedy
17 was like this totally cute person who played hide the
18 ICBM with both Khrushchev and Marilyn Monroe.

19 Now, let's see what else came and went. This.
20 The point I'm trying to make here is that very little in
21 our world is permanent, and I'm not talking about buggy
22 whips and Super 8 cameras. I'm speaking of entire
23 species, entire institutions, entire economies that we
24 imagined to be somehow guaranteed to us, but which turn
25 out to be as endangered as the snail darter.

1 So just for instance, NBC: Maybe you've been
2 reading about the Comcast deal. The giant cable company
3 has basically acquired NBC Universal from General
4 Electric in a multi billion dollar transaction. Now,
5 it's going to be interesting to see if Comcast can run a
6 TV network 24/7, considering it can't even seem to get a
7 repair truck to your house in a four-hour window, but
8 never mind that because NBC, the broadcast network, is
9 not going to be around for long.

10 In the next ten years, in my best guess, most
11 likely five, NBC will be just another cable channel on
12 the way to being no channel at all, and there are many
13 reasons for this.

14 The Chopping Block, now there's a self
15 fulfilling prophecy for you, but the fact is
16 unbelievably terrible programming is not the main reason
17 NBC, as a broadcast network, is doomed. The real reason
18 is a convergence of technology and simple economics to
19 undermine television's business model.

20 Now, forgive me here because this gets a little
21 bit technical, but as you shall soon see, not just NBC,
22 but all TV and all newspapers and all magazines and all
23 radio and Hollywood and what's left of the record
24 business are all in some big, big trouble, also the
25 advertising industry, and a little boutique soap company

1 called Proctor and Gamble, along with the other 1,000
2 leading national advertisers, but I'm getting a little
3 ahead of myself.

4 Where this all begins, of course, is with the
5 digital revolution. Now, I know that sounds like some
6 sort of news magazine cover headline, and by the way, I
7 would have put a copy of U.S. News up there, but it no
8 longer has a print edition because it itself is a
9 particularly victimized victim of the digital
10 revolution, a tectonic technological shift with
11 consequences akin to the industrial revolution. Many of
12 those consequences, of course, are extremely positive.

13 Some of them certainly are not. That's a porn
14 site, a Jihadist's site. Sorry, Hal, and it's actually
15 not just a joke, as we'll see in about three minutes,
16 but to explain why, first I'm going to have to go all
17 PowerPoint on you, but I promise you, this will be very
18 simple and very brief.

19 There's something like a thousand cable
20 channels. There's PlayStation and Wii and massively
21 multiplayer online gaming, almost 200 million websites,
22 including online gambling and online porn, at least that
23 many blogs, not to mention Facebook and MySpace and
24 YouTube. Last year Susan Boyle generated more than a
25 120 million YouTube views, astounding the world by

1 somehow miraculously singing while ugly.

2 Media wise, there are gazillions of choices.

3 Overall, more people are consuming more stuff, including
4 newspapers, magazines and TV, than ever before in human
5 history, but the audience is carved into smaller and
6 smaller slices. Consider this: In the last week of
7 December, last year, the highest rated TV series was
8 CBS's The Big Bang Theory. Has anywhere here seen The
9 Big Bang Theory? One, two? Actually that seems to make
10 sense. It was viewed by 5.6 percent of households. 50
11 years earlier the top show was Gunsmoke. It was viewed
12 by 40 percent of U.S. households.

13 The thing is, as audiences fragment, the amount
14 of revenue coming in, for any given piece of content,
15 goes down, down, down, below the point where the
16 publisher or broadcaster can continue to pay to produce
17 the thing. That's why, until very recently, there were
18 five days a week of Jay Leno in prime time, and I think
19 it's now like nine days a week of Dancing With the
20 Former Stars or whatever. It's cheaper. It's just
21 cheaper to do, but it's also suckier, and therefore
22 draws still fewer viewers, generating still less revenue
23 and so on into oblivion.

24 It is expensive to set up a Hollywood studio and
25 to build a thousand multiplexes. It's expensive to have

1 headquarters in Rockefeller Center and Burbank and to
2 support 200 affiliates. It's expensive to have 700
3 reporters and a hundred trucks and huge printing plants,
4 which, until now, is exactly how the media tycoons liked
5 it.

6 If you were Warner Brothers or Hearst or NBC,
7 there were a limited number of potential competitors
8 with the kind of capital to try to steal away your
9 market share. The capital requirement, that kind of
10 capital requirement is what economists call a barrier to
11 entry, and for the past 300 plus years, those barriers
12 have been damn near insurmountable.

13 Well, now Steven Spielberg and Rupert Murdoch
14 and CBS's Les Moonves have someone nipping at their
15 heels. He's a blogger, a very popular blogger, as a
16 matter of fact, and he has exactly the same access to
17 audience as Murdoch, only his cost of production and
18 distribution is zero, that's unless he wants to make
19 movies. A digital video cam could set him back nearly
20 \$200. I mean, can you see how this spells trouble for
21 the tycoons? 200 bucks is a barrier to almost nobody,
22 and when it comes to selling your content to audiences
23 and advertisers, free is a tough price to compete with.

24 I'm happy to report that in 2009, Apple sold
25 more than 3 billion songs on iTunes, accounting for most

1 of the \$3 and a half billion consumers spent on music
2 downloads. Unfortunately for the record industry, 95
3 percent of downloads, \$70 billion worth, were illegal,
4 stolen, pirated. As technologies like BitTorrent
5 proliferate and filing sharing hubs like Pirate Bay pop
6 up, the same will rapidly happen with TV and movies, and
7 in fact is happening already.

8 In 2009, the movie Star Trek was illegally
9 downloaded an estimated 10.9 million times, syphoning
10 off at least a hundred million dollars in box office
11 receipts. Maybe it isn't exactly piracy, but online
12 aggregators like Huffington Post and Google News sell
13 ads against excerpts of content created by others,
14 siphoning off ad revenue from every newspaper in the
15 world. Hal was talking about the 35 percent that the
16 newspapers get. Well, that's 65 percent that they don't
17 get, and that's why Google, our friend, is also Google,
18 our enemy.

19 Between 50 and 75 percent of DVR owners fast
20 forward through the commercials. When very soon 50
21 percent of U.S. households are equipped with DVRs, that
22 means between 25 and 35 percent of all ad spending on
23 T.V. will be zapped into oblivion, and increasingly,
24 advertisers are refusing to pay broadcasters for
25 reaching the zappers, putting yet more revenue pressure

1 on the networks.

2 Why does Mr. Viewer skip past the commercials?
3 Why? Well, for the same reason he deploys spam filters
4 on his computer and refuses to click on any banner ad at
5 any time for any reason. What is the matter with you
6 people? Do you not see how vulgar and inappropriate
7 that slide is?

8 Anyway, advertising people like to give trophies
9 to one another for creative genius and to parade Tony
10 the Tiger down Madison Avenue once a year, but if they
11 think people love their ads, they are sorely, tragically
12 mistaken. For more than three centuries, consumers have
13 put up with ads as part of the deal. It's the quid pro
14 quo, the unspoken compact that provided all of us with
15 free or subsidized content in exchange for having to sit
16 through 20 years of Mr. Whipple fondling toilet paper.

17 Oh, yes, some of the commercials are very clever
18 and funny, and some of them even worm their way into our
19 hearts, but by and large, they are and always have been
20 a nuisance. To most people, all advertising is spam,
21 the proof being that the moment technology afforded us
22 the opportunity to skip them, skip them we have.

23 I mentioned the Internet's ever expanding supply
24 of content. Well, much of that content, millions and
25 millions of websites and blogs and Facebook pages accept

1 advertising, which means an ever expanding supply of ad
2 inventory. As you know, there is an immutable principle
3 of economics called the law of supply and demand. As
4 supply increases, prices are pressured downward, and the
5 price that any advertiser can fetch for any ad anywhere
6 is going to be reduced, especially online.

7 That's yet another reason newspapers can't
8 convert their huge online audiences into big bucks. On
9 display advertising, they're competing with 11 year old
10 bloggers, whose ad space comes very cheap, and on
11 classified, once again, they're competing with free. As
12 I said, they don't call it a revolution for nothing.

13 By the way, never mind the ongoing demand for
14 media in general. Just because people want it doesn't
15 mean they'll pay for it. They've been trained for the
16 whole history of the Internet to believe that all
17 content is free, and neither all the king's horses nor
18 all the king's men can put that back Humpty Dumpty
19 together again.

20 If advertisers won't pay, and if individuals
21 won't pay, the grim fact is media and marketing have
22 been a mutually sustaining yin and yang for, depending
23 on how you measure it, 350 years, a symbiosis that has
24 been simply fantastic for everyone. We got free and
25 subsidized. Mr. Whipple got an audience, and media

1 companies got filthy rich allowing most of the people I
2 speak to to make a nice, tidy living.

3 It was a magnificent ecosystem, but it turns out
4 to have been just an accident of history, a happy
5 accident, but an accident nonetheless. It was an epoch,
6 an epoch in its waning days, and I've singled out
7 individual entities, but what I'm speaking about is not
8 just NBC and The Washington Post, but the entire
9 broadcast and newspaper industries, and I'm pleased to
10 report that magazines are far better off than
11 newspapers, in exactly the same way it is much better to
12 have multiple sclerosis than Lou Gehrig's disease.

13 In the past two years, 900 North American
14 magazine titles have vanished from the face of the
15 earth. According to the Bureau of Labor Statistics, in
16 the past year, 86,000 former employees of the periodical
17 and publishing industries have lost their jobs, and
18 there's just no reason to think that that's going to
19 slow down.

20 Cable is not pictured here, but that's no better
21 positioned in the long run than broadcast. Not only is
22 it exactly as vulnerable to TiVo, it's suffering from a
23 sort of autoimmune disease. The very cable that brings
24 the expensive programming into your house also pipes in
25 the broadband, which enables you to get virtually the

1 same programming online, without the hundred dollar a
2 month cable fee, so choose your metaphor: The body
3 attacking itself, being shot with your own gun. Either
4 way, it is fatal.

5 The last one on that slide is Ogilvy and Mather,
6 the global ad agency. The agency business isn't just a
7 toaster oven. The agency business is toast, because no
8 matter what anyone tells you, it derives its income from
9 creating and placing large ad campaigns, and the larger,
10 the more lucrative, but mass is going away, and the
11 agency business model does not adapt to micro.

12 So once again choose a metaphor. You think
13 toaster oven is a little, I don't know, strained? Okay.
14 Here's another way of looking at it. Think of the
15 people who make and place ads as not living in 2010 but
16 in 1810, and imagine them not as crafters of commercials
17 but as crafters of shoes. They're cobblers. They're
18 cobblers who have, for centuries themselves earned tidy
19 livings making custom shoes, only to see a steam powered
20 show factory mass producing shoes for tuppence on the
21 pound. Got the picture? Okay.

22 So to bring this back to where we began, how
23 would you like to be the guy who earns a living covering
24 the cobbling industry? Do you see what I'm saying?
25 There are toaster ovens, and there are toaster ovens,

1 and if my chaos scenario is correct, I'm the toaster
2 ovenist.

3 Complicating matters, ladies and gentlemen, and
4 not to get too personal here, but I am old. When I
5 started out in this business, there was one ringtone.
6 It went ring. I am so old that I've had two
7 colonoscopies. It actually wasn't too bad. The last
8 one, the results just came in, and they found a couple
9 of small polyps and a Starbucks. In college I took
10 chemistry. You know the periodic table of elements?
11 When I was in school, 29 of them. Zinc was a rumor.

12 So with all respect to the President, it is a
13 little late for me to retrain, and that's actually why
14 I'm here today. My plan A was to collect paychecks and
15 paid healthcare and journalize my way to retirement, but
16 that is not going to happen, so my plan B is to be a
17 scavenger feeding on the bloated corpse of my industry.

18 I don't want to be too negative. I do have some
19 positive news. As other sessions in these workshops
20 have highlighted, the very same forces that are
21 destroying mass media and mass marketing are creating
22 the most exciting, most inclusive, most democratized
23 times in human history. Thanks to digital tools and
24 connectivity, the power shift between the media and the
25 group formerly known as the audience is also happening

1 to other institutions: Business, government, politics,
2 science, the church. It's happening to graphic design,
3 music, even sports. The time when folks at the apex of
4 the pyramid got to dictate to the audience, the
5 electorate, the congregation, the customers, that is
6 coming to an end.

7 Ladies and gentlemen, the herd will be heard,
8 and the same sort of thing is happening in journalism:
9 Blogs, Twitter, hyper local news sites, aggregation,
10 crowd sourcing, podcasts, all power to the people, baby,
11 sticking it to the man. There's only one teensy
12 problem. Those tyrants at the top of the pyramid
13 dictating what content the news audience would receive,
14 that's pretty much the likes of me. We are the
15 dictators, the establishment, the elite. When the
16 unruly mob enters the Bastille, they will repopulate it
17 with us.

18 Well, I mean, did I not say at the beginning of
19 this presentation that I represent something larger than
20 myself? I am not just a toaster oven. I am a poster
21 toaster oven, the individual standing with the whole
22 doomed lot of us, the whole universe of trained,
23 experienced, professional journalists who, for three
24 centuries, could maintain a livelihood applying our
25 trade.

1 Our numbers are dwindling by the thousands and
2 thousands and thousands. This is not good news. Our
3 society, our democracy, needs me, I mean, not me me, but
4 the world of experience and judgment that I, at least
5 for the purposes of this slide show, represent.

6 In the short-term, news organizations will
7 simply retrench with painful cutbacks, not only on
8 investigations and enterprise reporting, but on the
9 basis of monitoring local, state and national
10 government. The medium term will be much worse as
11 liquidation and consolidation reduces the number of
12 newspapers and broadcasters by at least half, a
13 percentage I can cite with confidence because I've just
14 now made it up.

15 It's going to be a frightfully barren period of
16 chaos. For advertising as an industry and for the media
17 industry, it has for 350 years supported. In the long
18 run, that milk and honey of digital innovation will
19 begin to flow, and maybe micro payments will be a model
20 that emerges to guarantee resources and professionals,
21 but in the meantime, I can only see dark clouds with no
22 silver lining. Okay. Maybe one silver lining, because
23 if there's no newspapers, why then?

24 Thank you very much.

25 (Applause.)

1 MS. DESANTI: Thank you. Now, we move from
2 reporting on the facts to getting into some of the
3 proposals that have been made for ways to deal with the
4 issues that have been laid out for us.

5 Our first panel of this workshop will discuss
6 copyright issues in journalism, and it will be moderated
7 by Suzanne Michel, Deputy Director of the Office of
8 Policy Planning, and Dan Gilman, an attorney advisor in
9 our office. So would the panelists and the moderators
10 please come up?

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1 PANEL 1: CURRENT COPYRIGHT ISSUES IN JOURNALISM

2 MODERATORS:

3 SUZANNE MICHEL, FTC

4 DANIEL GILMAN, FTC

5 PANELISTS:

6 YOCHAI BENKLER, Jack N. And Lillian R. Berkman Professor

7 for Entrepreneurial Legal Studies, Harvard Law School;

8 Faculty Co-Director; Berkman Center for Internet and

9 Society

10 JAMES BOYLE, William Neal Reynolds Professor of Law,

11 Duke Law School

12 LAURA MALONE, Associate General Counsel, Intellectual

13 Property, The Associated Press

14 JAMES W. MARCOVITZ, Senior Vice President and Deputy

15 General Counsel News Corporation

16 KENNETH A. RICHIERI, Senior Vice President and General

17 Counsel, The New York Times Company

18 BRUCE W. SANFORD, Partner, Baker Hostetler

19

20

21 MS. MICHEL: Thank you. Thank you. Good

22 morning. My name is Suzanne Michel. I'm Deputy

23 Director here for Susan, and with me is Dan Gilman. We

24 will be talking about copyright.

25 The process of investigative journalism is

1 certainly expensive, and most and probably all of
2 everyone in the news industry would argue that the
3 product of that investigation and news story itself
4 requires some protection so that the news organization
5 can recoup its expenses, but how much protection is a
6 notoriously difficult question.

7 The answer to that question raises issues that
8 reach far beyond the content of any one news story and
9 implicate broader principles like free speech, public
10 discourse and creativity that always builds on something
11 that came before.

12 So today we're going to explore those difficult
13 issues. We're going to talk about how the legal
14 doctrines that afford the protection to that content of
15 news stories, including copyright law and the hot news
16 doctrine can be balanced with these other principles.

17 To help us with this process, we have a great
18 panel, and I thank you all for coming today. We have
19 Professor Yochai Benkler, who is the Berkman Professor
20 for Entrepreneurial Legal Studies at Harvard Law School
21 and the faculty co-director of the Berkman Center For
22 Internet and society. He's also the author of a
23 fascinating and insightful book relevant to this topic,
24 *The Wealth of Networks: How Social Production*
25 *Transforms Markets and Freedom.*"

1 Next we have Professor James Boyle. James is
2 the William Neal Reynolds Professor of Law and
3 co-founder of the Center For Study of Public Domain at
4 Duke Law School. He is also the author of an
5 entertaining and very readable book, I don't think you
6 don't need to be a lawyer to enjoy this one, "The Public
7 Domain: Enclosing the Commons of the Mind."

8 Laura Malone is Associate General Counsel for
9 intellectual property at The Associated Press. She's in
10 charge of protecting, managing and enforcing the
11 intellectual property rights of AP, and so you could say
12 she's in the trenches on this one.

13 Also with us is Jim Marcovitz. Jim is senior
14 vice president and deputy general counsel at News
15 Corporation. He's responsible for, among other things,
16 intellectual property matters there.

17 We have with us Ken Richieri. He is senior vice
18 president and general counsel of The New York Times, and
19 so deals both with these issues and the broader legal
20 issues for his newspaper and organization.

21 Finally, Bruce Sanford. Bruce is partner at
22 Baker Hostetler where he chairs the interdisciplinary
23 media and technology industry group. He's also the
24 author of several books on the media, free speech and
25 libel and privacy matters.

1 We're looking forward to a lively discussion.
2 We're going to run this panel as a moderated discussion
3 because I think these panelists have a lot to share with
4 each other.

5 As I throw out questions and we start the
6 process, I'll ask you to turn up your table tent like
7 this, I'll leave mine as a cue there, so that I can call
8 on you, and we can keep the process going.

9 I want to start with a bigger picture question:
10 Does it matter, these legal issues that we want to talk
11 about, and how much does it matter? Many news
12 organizations are facing financial difficulty, but to
13 what extent are those financial difficulties caused by
14 the use of others on the Internet of the original news
15 content of news organizations?

16 Yes, James?

17 MR. BOYLE: Thank you. I think comparing Hal
18 Varian's very instructive presentation to Mr. Garfield's
19 I think is a great way to begin that, and I think Hal's
20 presentation really shows how vanishingly small, even
21 the percentage that it is possible that illicit use of
22 news content makes up for in the actual problems of
23 newspapers, both the issue of a continuing decline from
24 the 1950s, the fact of disintermediation where you have
25 specialized sites providing the same information, the

1 difficulty in providing a licit business model, never
2 mind the illicit uses. Where is the licit business
3 model?

4 If you put all of these things in together, and
5 then I say, Okay, supposing we have absolutely perfect
6 enforcement of copyright law, and I'm perfectly happy to
7 enforce copyright law against the people who are
8 genuinely taking whole pieces of content and recopying
9 them on the Internet illicitly, imagine perfect
10 enforcement. I think it's a vanishingly small
11 percentage of the newspaper's problems.

12 So I think that to some extent I really think
13 that this is a little bit of a distraction from a real
14 social issue. There really is an issue. How is
15 investigative journalism going to be paid for is one I
16 care about a great deal, but the idea that we solve that
17 potentially by tweaking copyright law I think is just a
18 fundamental mistake.

19 MS. MICHEL: Any responses? Yes, Professor
20 Benkler.

21 MR. BENKLER: Unfortunately because I just flew
22 in I missed Hal Varian's presentation so I don't know to
23 what extent I'll be repeating, but it's important to
24 recognize that we are looking at a business that is used
25 to monopolize rates, a highly concentrated industry.

1 What is it? On the order of 95 percent of small to
2 mid-sized towns are single newspaper towns.

3 One major source of competition is simply the
4 fact that people can get roughly similar news from other
5 places, other newspapers next door, three towns away.
6 This is a massive component of the rates, and of course
7 classifieds, et cetera.

8 So the question is: What aspect of any of this
9 are we willing to give up? Are we willing to actually
10 give up other newspapers being the source? Are we
11 willing to give up the idea that national and global
12 sources of news becomes a way in which people get to
13 know the news so that in some sense they don't need to
14 read the local paper that's brought to the door? In
15 order to find out the news of the day, they can read the
16 New York Times or the LA Times wherever they happen to
17 be.

18 Those to my mind are major questions. Do we
19 actually want to limit craigslist or Monster.Com, and if
20 not, what on earth can we imagine that's happening here,
21 other than identifying a business source that has
22 succeeded in creating revenues and finding a way to
23 generate a right to draw the rents back from there where
24 they were lost when trucks stopped being the only way to
25 deliver locally relevant advertising?

1 MR. RICHIERI: I'll go back to your initial
2 question. I very much agree, copyright law did not
3 create the situation that newspapers and content
4 providers find themselves in. That has been created by
5 splitting off one of the major revenues sources, some of
6 the major revenue sources, the cheap one being
7 classified ads from the content that it was associated
8 with because of the delivery mechanism.

9 That said, I do think that copyright law or some
10 kind of law that protects the creation of content online
11 is important for the solution. It may not have caused
12 the situation that we're in, but if someone is going to
13 support the investment that is required to create news,
14 one needs to be able to monetize that in some kind of
15 way, and one can't do that if the entire work product
16 can be taken pretty much instantaneously.

17 MS. MICHEL: Bruce?

18 MR. SANFORD: Susan, going back to your original
19 question, I think one of the things that the Commission
20 could do in this entire process is to do some fact
21 finding and issue a report that may serve as the basis
22 for any kind of legislative recommendations or
23 proposals.

24 Fact finding in this area has shown I think from
25 a group called a Fair Syndication Consortium, in one

1 30-day period they found 75,000 unlicensed sites showing
2 U.S. newspaper content and 112,000 full copies of
3 newspaper content being used in an unauthorized way.

4 The amount of unauthorized usage, and that's the
5 point here, unauthorized usage of newspaper content, is
6 staggering, and that I think is something that we need
7 some real fact finding on.

8 I agree with Ken that copyright didn't cause the
9 problem. It ought to be more copyright like, copyright
10 type of protection such as the sort that England is now
11 considering in their something styled, that's just
12 proposed, Digital Economy Act. That's something that we
13 really ought to do in order to try to protect journalist
14 content in the digital age.

15 MS. MICHEL: Jim?

16 MR. MARCOVITZ: Thank you. Going back to your
17 original question and adding on to sort of Ken's and
18 Bruce's comments, consumers are reading and accessing
19 the news --

20 MS. DESANTI: Jim, could you please speak into
21 the mike? Thank you.

22 MR. MARCOVITZ: I'm sorry. Consumers are
23 accessing and reading the news quite differently than
24 they did say 20 years ago. There's a completely
25 different type of readership base as you look at people

1 under 50, under 40, under 30.

2 Newspapers, according to the Pew study, still
3 are the primary source of original news reports.
4 Newspaper organizations invest a substantial amount of
5 time and resources in gathering and creating original
6 news reports.

7 We are looking for a way to get a return on our
8 investment. Copyright didn't cause this problem, but
9 there are laws that we could look at that could coexist
10 along side copyright that could help news organizations
11 continue to make this investment being one of the
12 largest contributors to the worldwide knowledge base.

13 MS. MICHEL: Laura?

14 MS. MALONE: Thanks very much. I want to
15 address a few points that were brought up. I agree with
16 my newspaper colleagues here that we do need the
17 protection. No, copyright law did not cause the
18 problem. I don't think anybody in this room is
19 contending that copyright law caused the problem.
20 Copyright law is one remedy that we have in order to
21 protect our valuable content that we deliver.

22 We're a little bit different at the Associated
23 Press and sit a little bit differently than the
24 newspapers because we are specifically not relying on
25 classified ads, though our customers are; not

1 specifically relying on advertising, though our
2 customers are.

3 I can sit and look from my perspective at all of
4 the different AP stories that have been distributed to
5 the various different customers and see how they've been
6 lawfully and legally used and also unlawfully, and as
7 you say, Professor, illicitly used, and I can say,
8 absolutely, it causes quite a bit of harm.

9 When I get a call from a member newspaper, a
10 member newspaper organization or member broadcaster from
11 somewhere in the country that says, Why am I paying
12 these membership dues and why am I paying the fees to
13 you that I have to pay when the guy across the street is
14 just copying and pasting and putting it up on his site,
15 and it's all over Facebook and everybody can access it?
16 Why am I paying for legitimate reporting? I'm looking
17 at you two. I don't mean to be after you, but why am I
18 paying for legitimate reporting from the original
19 source, from the Associated Press or whatever source I'm
20 paying for it, when the guy across the street is sitting
21 at his computer and retyping or cutting and pasting or
22 scraping and posting?

23 I mean, those are serious issues that we have to
24 deal with, so, yes, there is -- it does have quite an
25 economic effect. Copyright law is just one of the

1 remedies that we can engage. I think Jim is alluding to
2 a few other things, contract law, hot news
3 misappropriation, of course, that we can talk about as
4 well.

5 MS. MICHEL: Okay. James?

6 MR. BOYLE: Thank you. I think that the call
7 for fact finding is profoundly well judged because I
8 think if you compared Hal's speech to Mr. Garfield's
9 speech, I'm looking at Hal when I say this, Mr.
10 Garfield's speech was far more entertaining, largely
11 because it was almost -- I would say 50 percent of it is
12 what is commonly believed and simply factually wrong.
13 It's much more entertaining to be wrong with cute slides
14 than it is to actually get into the data.

15 So you can't compete with free, absolutely.
16 It's impossible. No one can compete with free. If
17 there were free water, the bottled water industry
18 would disappear. It just happens not to be true, but
19 it's very entertaining.

20 So yes, there are illicit copies of newspapers.
21 A, that's already illegal and it's a violation of
22 Section 106 of the Copyright Act, and there are powerful
23 federal penalties available, both civil and criminal.

24 B, you cannot confuse, as Mr. Garfield's
25 presentation did, the number of illicit copies with

1 actual negative effect. So he says, Oh, there's this
2 Star Trek movie out, and it's being downloaded, and then
3 he gives the, forgive me, somewhat inflated numbers
4 given by the content industry, I understand why they do
5 it, and then he goes, and therefore, it lost a hundred
6 million dollars.

7 It's like, yeah, because each one of those is
8 definitely someone who would have paid 8.50, and we
9 currently see no box office blockbusters actually in the
10 cinemas, again, very entertaining and totally false.
11 It's just not the case. In fact, some big picture
12 movies are getting larger revenues.

13 So I think what we have to do is look at actual
14 impact from illicit copying. That doesn't mean the
15 number of times the stuff is copied, nor even the number
16 of page views, though that would be starting to get
17 something. It is the foregone revenue stream produced
18 by it. That's the first thing that we have to get.

19 Then we have to say, how much of this is not
20 already illegal under existing law? Then we have to
21 say, How much of the remainder should be illegal, and I
22 think once you come to all of those things, the answer
23 is hardly any and not at all.

24 MS. MICHEL: A lot of this discussion is focused
25 on illicit copying, wholesale copying. There are other

1 ways that Internet news sites use content from original
2 news stories, however, call it the gray area, call it
3 activities perhaps completely legal under current
4 copyright law. We're thinking about the news
5 aggregators and the headline and the links.

6 Let's focus on that then. How much of a problem
7 is that for news organizations to be able to recoup
8 their investment in investigative journalism, and does
9 intellectual property copyright law have any role to
10 play in addressing those issues?

11 Would anyone like to take that on? Bruce,
12 please.

13 MR. SANFORD: Sure, Suzanne. I think the
14 problem here is when you're talking about aggregators,
15 you do have to say, What specific activity are we
16 talking about, and you do have to categorize them, as
17 James says, from the ones who are clearly creating
18 copyright infringement to those that would have a fair
19 use defense.

20 Then the question, if you start litigating
21 those, as a litigator, I will tell you what happens.
22 What happens is that plaintiffs tend to pick strong
23 cases where the fair use defense is not very viable, and
24 they win many of those cases, plaintiffs being
25 plaintiffs, and you will find some aggregators going

1 down the tubes basically in copyright infringement
2 cases. That I think is almost certain to happen if the
3 status quo continues.

4 You may find some cases where an aggregator will
5 beat the rap with a fair use defense, and then you will
6 end up with sort of a chaotic bunch of judicial
7 decisions that are inconsistent or difficult to apply
8 factually. It does seem to me if that's the likely
9 scenario that happens, and I think it is from a
10 litigation standpoint, that it is in everybody's
11 interest, the interest of the aggregators, the interest
12 of the search engines, the interest of publishers and
13 content providers, to agree on some sort of rules of the
14 road.

15 They can do that either in a legislative format
16 or as business matters, but that, it seems to me, needs
17 to be done before this begins to disassemble into
18 judicial decisions and the scenario that I've painted,
19 and that's really why I want to thank the Chairman and
20 the Commission for this initiative, because I think it
21 can be the fact finding basis for advancing that
22 discussion, that legislative discussion.

23 MS. MICHEL: You suggest we haven't seen that
24 litigation yet. Do you have any sense of why not, and
25 are you suggesting that there may be more in the future?

1 MR. SANFORD: Yes and yes. I think we haven't
2 seen them actually yet because I think as a matter of
3 business deals, a lot of the players in the industries
4 are talking business. They're trying to find a way to
5 resolve it in the marketplace, and I think there's a lot
6 of that going on, a lot of posturing going on.

7 I think there will be litigation coming out.
8 There are going to be people who feel that they have
9 strong cases, that the fair use defense in some
10 situations with aggregators is fatuous, to say the
11 least, and they will sue, and you will get some powerful
12 decisions I think in that area.

13 I think that may or may not be -- James knows a
14 lot more about this than I do, but that may or may not
15 be good for the fair use defense in copyright law
16 because the fair use defense in copyright law has not
17 really been working out in a gym in the digital
18 revolution.

19 It's not a doctrine it seems to me that has
20 really been tested or can easily be tested in a digital
21 world, in an online world, and that's why I think it's
22 probably time to look at this from a legislative
23 standpoint, public policy standpoint and say: What
24 should the fair use doctrine be in this context? I
25 think we have this one case, and the wonderful New York

1 Times people who got sued in the Gateway case.

2 MR. RICHIERI: Gate house.

3 MR. SANFORD: There was an expert witness in
4 that case who made I think a very interesting argument
5 about the application of the fair use doctrine to
6 aggregating against The New York Times in that case, and
7 really, he put the touchstone on the frequency of use
8 and whether the aggregators were supplanting the
9 economic value of the content, and that I think will
10 boil down to be the test.

11 I think that, in many cases, will be a very
12 difficult test for aggregators to meet because I think
13 their products do supplant the economic value of the
14 content, and I think demonstrably so.

15 MS. MICHEL: Was that Professor Doug Lichtman's
16 professional report?

17 MR. SANFORD: Yes.

18 MS. MICHEL: Professor Benkler?

19 MR. BENKLER: So I think it's important to go
20 back to the beginning of your question, which is to say
21 there is a class of behaviors that are legal at the
22 moment. They're legal at the moment because they
23 reflect a certain judgment about the limitations and the
24 severe ambiguity of the benefits of the effects of
25 copyright and proprietary like models in information

1 production.

2 There's always a trade-off between providing
3 some revenue to one round of information creators in
4 exchange for increasing the costs of others.
5 Information and opinion are made from information and
6 opinion. The continuous flow of news through a system
7 is absolutely central to all of these organizations and
8 particularly in the context in which a wide new set of
9 lower cost models, some commercial, some non commercial,
10 some nonprofit, some completely voluntary, is emerging.

11 The risk of introducing a proprietary like right
12 as a solution vastly overweighs whatever discrete
13 advantages there are, and again I will note how many
14 people around the table said copyright is not the
15 problem. So the question is: How precise a hammer this
16 is for the particular set of problems there are. You
17 could go around and say, You know what, people have come
18 up with solutions that say let's tax Internet access to
19 pay for musicians and movies.

20 That's been a proposal that's been a serious
21 proposal on the table for eight or nine years. There's
22 no fundamentally bigger reason not to simply say, let's
23 tax Internet access and subsidize newspapers than there
24 is to say let's take a subset of producers, introduce a
25 right that is not itself coherent on its own bottom as a

1 cause and siphon off revenues to subsidize this
2 industry.

3 When you have a system of laws, a system of
4 rules that we know produces inefficient rents, we know
5 produces higher cost for information production, and we
6 know has its own political dynamic that always ratchets
7 up over time as you get concentrated interests being
8 interested in extending the right and deepening it and
9 relatively diffuse interests on the other side.

10 So it is an extremely volatile material to use
11 as a solution that is not fundamentally different from
12 simply saying the threat is the Internet. Let's tax the
13 Internet and pay these organizations so they can keep
14 doing business in the particular model that they've done
15 in the 20th century. I'm not sure that's acceptable.

16 As to the particular cases, you're not the first
17 industry to come up against this. If you look at Kelly
18 versus Arriba or Perfect 10 at the search engine, we
19 already know that searching the data, identifying
20 discrete little components that are the basis for them
21 to link is perfectly fine. We also know from copyright
22 that just taking the whole content and putting it up
23 there and displaying it is not fine.

24 So maybe at the margin there will be a poorly
25 decided or a well decided case that will go one way or

1 the other because judges will or won't have sympathies
2 in one form or another, and as you say, the litigation
3 will choose the best case, whatever it is.

4 The whole solution space that this looks at is a
5 highly ambiguous and problematic solution space for this
6 kind of problem that goes to the very heart of that the
7 fact that information, when it's controlled, undermines
8 and increases the costs of information production
9 itself.

10 MS. MICHEL: That solution space and those
11 questions may be worked out in the courts through the
12 common law process of interpreting the fair use
13 doctrine.

14 Is that a process that you feel confident in to
15 get us to the right place, to provide the protection
16 that some need, and also the freedom to use information
17 that others need?

18 MR. BENKLER: No, I don't actually. I'm not at
19 all thrilled with the way in which courts have been able
20 to develop the fair use doctrine. It has not been
21 completely useless, but it's relatively expensive. It's
22 relatively susceptible to local manipulation in terms of
23 who the defendant is and who the plaintiff is so that
24 it's far from an ideal setting.

25 The baseline current copyright law is one that

1 tilts against many of the practices that are in the gray
2 area and might be the solution and for things that I
3 don't think anyone around this table argues are illegal,
4 should be illegal, but won't make a difference to the
5 revenues of the industries. They're irrelevant, but
6 fair use itself is a highly uncertain doctrine.

7 MS. MICHEL: Do you have any thoughts on what to
8 do about that? Is it like democracy? It's the worst
9 situation, worst case except for all of the others? How
10 do we deal with that then?

11 MR. BENKLER: I don't think the solution is a
12 government created new right at all.

13 MS. MICHEL: Okay.

14 MR. BENKLER: I think we have the baseline that
15 we have. There will be battles within the political
16 economies. There will be battles within the courts. It
17 will move a little bit this way, a little bit that way.
18 There's enough sufficient money on both sides to suggest
19 that the litigation won't clearly go in one direction or
20 another, and a whole new set of business models is
21 emerging.

22 Some of them you will get global news sites that
23 will continue to use advertising and will have much
24 larger numbers of people looking at smaller sites with
25 more refined advertising. You will have some nonprofit

1 models. You will have some hyper local models. You
2 will have some people who are completely dedicated to
3 professional journalism and are willing to live with
4 lower returns and able to leverage the enormous
5 abilities that the net provides in order to produce new
6 journalism.

7 You have already the rise of the party presses
8 in the large scaled blogs. It's not as though we're in
9 a universe where -- and I remember this. There were
10 papers in the early '90s talking about putting cars on
11 the information super highway. If we don't have
12 copyright, there will be no content here. Well, as it
13 turns out, we didn't quite clamp down on everything, and
14 it turns out there's one or two things to stumble across
15 on the net.

16 So there is an emergency for a particular
17 industry that is used to extremely high rents in a new
18 competitive environment. It is looking for a set of
19 interventions that will change the present law, create
20 barriers to particular forms of competition so that it
21 can extract values.

22 The simplest solution is do nothing. At this
23 point it is not at all clear that -- do nothing of this
24 kind, of constraining information. You can imagine
25 situations with increasing investment in making

1 government data more easily available so that relatively
2 low cost models can collect.

3 You can maybe decide that you want to invest
4 some, although you don't want too much of the whole
5 media environment being supported by government. You
6 might imagine some subsidies or others. You might
7 convene about new nonprofit models in one form or
8 another. You might convene about how journalism schools
9 teach journalists to be their own small scale business
10 people.

11 There are all sorts of things you could do other
12 than interjecting this new right that is intended to
13 basically make it more expensive for new business models
14 to find out what's going on there and get people the
15 information they want.

16 MS. MICHEL: Ken, thoughts on aggregators?

17 MR. RICHIERI: My time was so long ago, I
18 forgot.

19 MS. MICHEL: Well, let me take us back to the
20 aggregators.

21 MR, RICHIERI: Yes, I'm going to go back to the
22 aggregation. I think for one thing when you look at the
23 headlines and links issue, most of our sites sponsor RSS
24 feeds, which make that easier, so I think we need to
25 understand we are in a net. It's called a net because

1 it's interconnected, and that any vibrant news or
2 information site, that's going to be a component of
3 that.

4 So the first thing I would say is that the word
5 aggregator and aggregating is actually too broad a word
6 in some ways. It covers a variety of sins, and it
7 covers some things that aren't even close to being sins.
8 So I think when people discuss aggregation, you have the
9 good things or the evil things about the aggregation,
10 you really need to focus on what you are talking about.

11 Taking the Times site as an example, we have RSS
12 feeds where we have our content linked out to others,
13 and in many of our news -- not the news article, but
14 adjacent to the news article there will be links out to
15 other sites who are discussing the same content, and I
16 think that's both perfectly appropriate.

17 That is in some way, shape or form how the net
18 is evolving, and that's how it's going to be, but I
19 would take Bruce's point. Some people use these tools
20 to create substitutability, and there is a Potter
21 Stewart aspect of it, you know when you see it, and I
22 won't be the first to say it, but that is a different
23 kettle of fish.

24 I am not sure they're really adding anything.
25 Don't forget, it is true, Garfield's presentation was

1 entertaining, but some things he said were actually
2 true. A ten year old kid does have access to everybody
3 anywhere. It's not like someone who is, making an
4 example, taking New York Times content and putting it on
5 his site and is reaching a population that couldn't,
6 with the same click, get to the original source of the
7 content. They're not creating a new market or anything
8 like that, not exploring a world that has not explored
9 before.

10 MS. MICHEL: Is substitutability a touchstone
11 then for how we ought to be thinking about this, that
12 our concern is for sites that are substituting for the
13 original news content?

14 MR. RICHERI: Well, again as I said, it's
15 something you know when you see it to some extent. I
16 mean, a headline and a clean link back that's not
17 interrupted by an ad that's designed to essentially give
18 the user of that site a cue to say, You want more, here
19 it is, I think that's perfectly fine, and everyone
20 benefits by that.

21 Where one's content is used oftentimes frankly
22 in ways that don't directly violate copyright but are
23 used to create an audience at the other site, okay, to
24 raise commentary about your content, your content is
25 used to create somebody else's audience, yeah, that's a

1 substitutability issue.

2 MS. MICHEL: Jim?

3 MR. MARCOVITZ: To add on to Ken's point, when
4 Ken talks about The Times making available RSS feeds and
5 the like, he's talking about a permission based system
6 where he's allowing access to those RSS feeds based on
7 permission and also permissions that they establish.

8 What we would like to see is a permission-based
9 economy where we could set the value for our content and
10 people come to us and seek permission to use it. Just
11 like an RSS feed, there are permissions attached to it.
12 If aggregators would like to build business based on the
13 use of our content, they should come to us to seek
14 permission to obtain it on terms that we would sell.

15 MS. MICHEL: Let's go Laura and then James.

16 MS. MALONE: I just want to add a little bit
17 more to what Jim said in saying that the Associated
18 Press has relationships with the major aggregators, so I
19 just need to preface my remarks that way.

20 When we're talking about usurping the value of
21 the content, usurping the economic gain from the
22 original site and from the originator, one of the things
23 that I think that we need to talk about is the way
24 viewers and consumers are reading their news and the
25 habits in which they are now consuming their news

1 compared to the way it was several years ago when people
2 sat with newspapers.

3 And I've heard people say a few times, Sure, we
4 understand that copyright law protects when someone
5 takes an entire story and republishes that entire story
6 somewhere else without the permission, or as Jim says,
7 the RSS permission even.

8 What we're talking about is news aggregation
9 sites where they take headline and lead, which can be if
10 it's a well written lead and well written headline, the
11 way they teach in J schools and the way most news
12 organizations teach their reporters, that's the heart of
13 the story, and the way people consume their news is to
14 look at the top two or three things, read real quickly,
15 move on to the next article.

16 They're not going and they're not clicking
17 through. To Ken's point, they're not clicking through
18 to the original source to read the entire detailed graph
19 four, graph five, graph six. They've got what they need
20 in the headline and the lead which can be one or two
21 graphs, and that is supplanting what's happening out
22 there with people not going to The New York Times
23 because they're reading it on Google News or they're not
24 going to The Washington Post because they're reading it
25 aggregated somewhere else, and I think that there is a

1 problem with that.

2 We do need to be able to say that we, the
3 content owners, we, the copyright owners, get to set the
4 parameters by which people can republish our stuff. If
5 people want to build sites based on the news that is
6 published by any of the news organizations, that's
7 great. We'll give them a license.

8 Licenses are not difficult to get, and they're
9 not terribly expensive. Talk about a barrier to entry.
10 It's not that difficult. It's just that people, because
11 they can do it for free, are doing it for free and
12 assuming that that's all right, and then raising a stink
13 if news organizations bring a copyright infringement
14 claim or send a DMCA take down notice, make a stink and
15 say, News is free, what's the matter with you, don't you
16 know anything about the First Amendment, and why are you
17 keeping the information away from us?

18 So there's that social thing of the uproar and
19 the uprising when news organizations try to enforce their
20 copyrights. There's a whole bunch of things. I just
21 thought I would throw them out.

22 MS. MICHEL: James?

23 MR. BOYLE: I think some sort of legal clarity
24 here might be useful. We're talking about fair use, but
25 in fact fair use, although important, is perhaps the

1 least important of the limitations on copyright around
2 which all of this depends.

3 The most important limitation on copyright, one
4 which newspaper and the AP use all the time, is the
5 idea/expression and fact/expression dichotomy.
6 Copyright doesn't cover facts, and it doesn't cover
7 ideas, and thank goodness for newspapers because if it
8 did, and some of their current proposals seem close to
9 suggesting that it did, they would be almost incapable
10 of doing their business because if anyone actually was
11 the first person to uncover a fact or an idea, they
12 would be prohibited from using it, which of course would
13 be devastating to the newspapers, to the First
14 Amendment, to our quality in general.

15 So the first limitation is simply that facts and
16 ideas go immediately into the public domain, even if
17 they're contained within works that are otherwise
18 originally protected under copyright, and that is one of
19 the things that people are talking about here.

20 It's also notable that people keep talking about
21 return on investment. Return on investment is an
22 extremely important issue for a business matter. It's
23 very important for us to focus on sweat of the brow and
24 the way it gets monetized.

25 It is, however, something that's utterly foreign

1 to copyright law. Supreme Court has clarified that in
2 the Feist case, so the idea that you get copyright by
3 putting labor in things or that rights follow labor is
4 not only wrong, but the Supreme Court has said
5 unconstitutional, at least under the copyright clause,
6 so that's I think worth noting.

7 So then I think we can focus on the kinds of
8 uses that are interfering with monetization, which as I
9 suggested, if you go down a list of things that are
10 actually hurting newspapers and get to the illicit uses,
11 I think it's small, but take use by aggregators.

12 Aggregators, as I think is very rightly --
13 we've really got to differentiate. Google News, as
14 compared to a splog, a spam blog, simply scrapes
15 everything, and these are very different things, and,
16 You need to think about them differently.

17 When you get to things like aggregators who
18 simply do a headline, headlines, de minimus use, long
19 standing provisions of copyright law saying that titles
20 in any event are not copyrightable, you're getting very
21 close to what's called merger, which is the facts and
22 expression, the very limited ways of writing something.
23 As Ms. Malone points out, a well written lead covers all
24 of the facts in the first sentence.

25 There are very few ways of expressing those

1 facts if it's a well written lead, and it's a story
2 about facts, which means that copyright doesn't cover
3 that at all because the copyright has merged with the
4 expression, and actually an attempt to control the
5 expression would be deeply problematic, problematic in
6 ways that should deeply worry news companies which
7 depend on their ability to reach out, including to
8 copyrighted content and extract facts and ideas.

9 So I really think when we get all of these
10 things and we say, If you really don't want to be
11 aggregated, why don't you put your robots.txt file and
12 just say, I don't want to be indexed. Well, the answer
13 is, Well, we want to be indexed, okay, we want to be
14 indexed and we want everybody to do that.

15 What we want instead is to exercise a right
16 which currently isn't given by copyright law to make you
17 pay for permission to link through to the story. I
18 think that has deep legal problems, and I think its
19 unintended consequences would be massive. There are
20 even some constitutional issues.

21 Leaving all those aside, I think the problem
22 there is what Hal Varian mentioned, Bertrand
23 competition. If you genuinely attempt to charge for
24 something for which there is substitutable content,
25 price comes down to marginal cost. Marginal cost is

1 close to zero. That's a problem for all of us, not just
2 for the newspapers because then we start worrying about
3 investing in reporting that is far away, covering very
4 powerful people who have lots of interest in shutting
5 people up, all right.

6 That kind of stuff, we need to think about how
7 it's going to be paid for. I am deeply concerned about
8 that. I pay for The New York Times. I love The New
9 York Times. I pay for The New Yorker. I get paid by
10 The Financial Times. I find my relationship with my
11 paycheck deeply attractive.

12 I wish for it to continue. Don't get me wrong.
13 It's not that I'm not on your side. I'm on your side.
14 This is the wrong tool. It would do a lot of damage,
15 including to you, and it's a massive distraction from
16 the real problems, so this is not an expression of lack
17 of sympathy or even lack of deep social interest.

18 I think it's a different point that we're
19 making, which is: Is this really the right venue to
20 address these issues in ways that don't end up creating
21 more problems than they cause?

22 MS. MICHEL: Ken?

23 MR. RICHIERI: Let me confront that a little
24 bit. First, I think part of what James says, I do agree
25 with. I do think that the ability of a site to

1 determine whether or not it's going to be aggregated by
2 a lot of using of robots.txt or other protocol is fine,
3 but I think we should recognize, there's no law that
4 requires aggregators to use any kind of protocol, and
5 there are some, and Google is one that does use a
6 protocol, and I think The Times has elected to be in
7 Google News, but if it decided not to, it would ban the
8 search and it would be perfectly fine.

9 On the other hand, we have many aggregators,
10 particularly in the mobile world, they present
11 themselves to our servers as a phone, as an iPhone, and
12 in fact, they're aggregators. Once they're inside the
13 system, they're aggregating hundreds of thousands, if
14 not millions of pages, and we're in their index, and I
15 don't see why it would do any violence to anybody's
16 copyrights or anything else to require someone, require
17 an aggregator who wants to show up and index your site
18 to present themselves in a technologically cohesive way
19 so that the site can elect not to be aggregated in the
20 index.

21 I don't see that as a copyright or any other
22 issue. I think that's a permission based system, and
23 that aspect of it ought to be fine, and in many cases
24 sites may choose to sign up and be in an index or a
25 search engine, or they may choose to be in some and not

1 others, but that ought to be the site's choice.

2 MS. MICHEL: Jim?

3 MR. MARCOVITZ: Adding on to this, I think again
4 we are talking about laws that could coexist along side
5 copyright. Hot news is something that could be looked
6 at. I think what Ken just brought up about laws around
7 technological standards, robots.txt is just fine. There
8 is no law out there that says, Yes, you know what,
9 website, you have to identify yourself as a spider or an
10 aggregator. ACAP, robots.txt is great. It's very
11 limiting. People haven't adopted the ACAP type standard
12 yet.

13 It's really about developing a permissions based
14 system to allow people in and out and utilizing
15 different tools to fight different forms of aggregation.

16 MS. MICHEL: Jim, do you see much of a
17 distinction between an opt-out permissions based system
18 versus a opt-in? Robots.txt, you opt-out, you don't
19 have to seek the permission, but the content provider
20 can opt-out.

21 MR. MARCOVITZ: I mean, opt-in, it tells you
22 that -- it's only opt-out now because there's nothing
23 that says to someone that you have to abide by these
24 instructions, and I think you have to shift that
25 paradigm to one that is permission based as opposed to

1 opt-out based.

2 MR. RICHIERI: I'm going to be different and
3 just say, if people were required, if there was a
4 protocol that spiders were required to adhere to and
5 they had a simple technological way for the sites to
6 deal with it, I would live with opt-out. That's fine
7 from my perspective.

8 MS. MICHEL: Bruce?

9 MR. SANFORD: Suzanne, this is probably a
10 philosophical discussion from Professor Boyle and myself
11 that is beyond the scope of this workshop, but I do
12 think that the whole issue of whether you recommend some
13 sort of federal law in the hot news area, in the area of
14 unfair competition, if you will, to address the unfair
15 taking of the extracting the value of journalistic
16 content on the web and whether that is addressed as a
17 matter of unfair competition law or copyright law is a
18 fair question.

19 James refers to the Feist case, which is a 1991
20 case from the Supreme Court in which the Supreme Court
21 examines the Congressional intent behind the copyright
22 law. It's not Constitutional. They're doing a
23 legislative history examination it seems to me, and
24 they're saying that Congress did not intend for
25 copyright law to extend to sweat of the brow type of

1 copyright protection, that copyright law protects the
2 expression, as James said, not the effort behind,
3 underlying, the thing.

4 That's a case involving telephone directories
5 from Kansas, for goodness sakes, and I think as a
6 reasonable discussion that could be had either on the
7 Hill or in courts, I would think on the Hill in terms of
8 what copyright policy should be in the digital age,
9 there's a reasonable question of whether that should be
10 true in the United States going forward.

11 I think that conversation is going to be had in
12 Europe, and I think you're going to see a different kind
13 of approach to copyright protection that does extend to
14 some kind of recognition that copyright should protect
15 the sweat of the brow, should protect the effort
16 underlying the expression.

17 James may not like that, and I think
18 philosophically, I think it's probably the way to go
19 with the digital, but that is a discussion that
20 certainly will be had here in this country and around
21 the world about the extent of copyright protection going
22 forward.

23 MS. MICHEL: Before we move to that topic, which
24 is our next topic, let me ask you: Do you have any
25 specific recommendations or suggestions or something you

1 would like to see happen with fair use?

2 MR. SANFORD: I think as I said before, I think
3 it's in everybody's interest on fair use to come to some
4 kind of resolution about practices, business practices
5 and uses and abuses of journalistic content on the web
6 and to deal with that in a marketplace solution.

7 I think that's preferable to litigation, and the
8 history of copyright legislation on the Hill, as you
9 well know, is that it is tortuous. It takes a long
10 time. Lots of people get involved. Everybody has their
11 say, and it's not really suited for speedy solutions.

12 On the other hand, if that dialogue and that
13 discussion on the Hill has to take place in order to
14 create leverage for marketplace solutions, then maybe it
15 should take place. Clearly there are issues about fair
16 use that may start emerging in litigation and may
17 advance the situation faster than anyone says.

18 MR. BOYLE: Suzanne, can I just clarify one
19 legal point very, very quickly on Feist?

20 MS. MICHEL: Yes. Thank you.

21 MR. BOYLE: Just on Feist, I think it's worth
22 reading what they actually said. "While it may seem
23 unjust the publishers must share in certain situations
24 their work product with others free of charge, that is
25 not some unforeseen by-product of a statutory scheme.

1 Rather, it is the essence of copyright and a
2 constitutional requirement."

3 MS. MICHEL: Professor Benkler?

4 MR. BENKLER: Not to be outdone by my
5 prophesorial colleague, quoting not from Feist, quoting
6 not from Kansas Phone Directories, quoting from Justice
7 Pitney in International News Service versus Associated
8 Press: "It is not to be supposed that the framers of
9 the Constitution, when they empowered Congress to
10 promote the progress of science and the useful arts by
11 securing," et cetera, "intended to confer upon one who
12 might happen to be the first to report a historic event
13 the exclusive right for any period to spread the
14 knowledge of it."

15 This beguiling the idea of permissions
16 everywhere. Permissions for who? When a New York Times
17 reporter who knows Spanish reads three newspapers from
18 Chile and puts together insight about what is going on
19 in the earthquake and how people think, permissions?
20 When any reporter sits and combines what they hear with
21 seven other reports they have listened to, permissions?
22 You want to live in a permissions system that facts are
23 permitted?

24 That is exactly the point about the
25 fact/expression dichotomy. We exist in the world where

1 facts are -- as Justice Brandeis put it in the same
2 case, and remember, who were the ones who objected to
3 the court in INS v. AP? Our First Amendment heroes,
4 Brandeis and Holmes, those were the two who thought the
5 court went too far. What did the court do in hot news
6 misappropriation?

7 The British government wanted to penalize
8 William Randall first for opposing U.S. entry into the
9 war, so they blocked off his use of the cables.
10 Associated Press used that fact to competitive
11 advantage, and the United States Supreme Court said,
12 That's fine, you can implement the censorial interest of
13 the British government on internal U.S. politics by
14 applying this right. That is the source. Who objected
15 to it? The core lights of our modern First Amendment
16 doctrine.

17 Facts, as Louis Brandeis said, should be as free
18 as the air to common use. We do not have a permissions
19 systems for breathing.

20 MS. MICHEL: Let's talk about the hot news
21 doctrine then, which really raises this issue, a
22 difficult and interesting philosophical issue also. We
23 have a hot news doctrine in our law in the INS case that
24 you mentioned.

25 Do you see the contours of that doctrine as it

1 currently stands as something that, depending on your
2 viewpoint, is helpful to the news industry or harmful to
3 public discourse? Then after we talk about how it
4 currently stands, I think that will set us up for
5 discussion of whether it should be changed in any way.
6 Any thoughts on that?

7 MR. BOYLE: Well, I think for the moment it's of
8 very limited use. It's used occasionally because it's
9 only a state right. I think it is used effectively
10 occasionally to shut down. It was used initially by The
11 New York Times and The Washington Post as a concomitant
12 to a copyright claim, which was a little shaky on a site
13 in the '90s, pre history of Internet, to deal with a
14 site that was framing. I think it was, in fact, the hot
15 news site, right?

16 MR. RICHIERI: Yes.

17 MR. BOYLE: So you used a New York State, if I
18 remember right, misappropriation claim there, but I
19 think no one at the moment would claim that the hot news
20 doctrine is of pervasive importance. I think it's
21 probably, candidly speaking, extra boilerplate in a
22 threatening letter or email that gets sent to people,
23 which may have limited effects in a situation like the
24 framing sites, but I don't think it's central at the
25 moment.

1 MS. MICHEL: Laura?

2 MS. MALONE: I'm going to surprise you, I
3 disagree. Hot news misappropriation is a state right,
4 as you've identified, and it is a misappropriation
5 right, and the arguments on both sides are: We have
6 Feist. Feist says no more sweat of the brow, we can't
7 protect it under copyright law.

8 The INS case, which has now been -- the Motorola
9 case, the NBA versus Motorola stats case, and most
10 recently we had one in New York which is Associated
11 Press versus All Headline News, we were able to
12 successfully at least bring the hot news
13 misappropriation claim. The Judge refused to dismiss it
14 on a motion for dismissal and said that hot news is
15 alive and well, even in this digital Internet age, at
16 least in the state of New York which was good for us.

17 Hot news misappropriation does protect what you
18 could call sweat of the brow. It protects people. It
19 protects the news organizations who are sending their
20 reporters out at a cost, and that cost is not just
21 dollars and cents. That cost is also lives. There are
22 people who are sitting in their homes on their computers
23 reading what the AP has reported at a cost and retyping
24 it, sending it and reselling it, so there's a free
25 riding that happens.

1 There are direct competitors. Associated Press
2 is losing its customers because they were able to
3 purchase it at a lower cost from the person who sat in
4 his living room and retyped the stories and stripped the
5 Associated Press's credit off of it.

6 There's a disincentive, because if the news
7 organizations are not going to be able to continue to
8 sell their product and still have to spend the kind of
9 money and, as I say, cost in lives in order to get that
10 news reported and distributed and disseminated to the
11 people who want the information, there's going to be a
12 serious disincentive.

13 We're going to be put fewer reporters out in the
14 field. We're going to have fewer people and fewer
15 bureaus out there. We're going to have fewer people to
16 read those three Chilean reports, those three Chilean
17 reports that were gotten by people who were there on the
18 site doing original sourcing and doing original
19 reporting.

20 So I don't think it's just a footnote, though I
21 do put it in my copyright infringement letters as well.
22 I rely very heavily on hot news misappropriation. I
23 think it is absolutely appropriate, and right now it's
24 not codified. It's common law, and it's not probably in
25 all 50 states. It hasn't been tested in all 50.

1 MS. MICHEL: Laura, I think part of what James
2 might have been alluding to is that the hot news
3 doctrine as it's discussed in the Motorola case can be
4 viewed as fairly limited. It doesn't hit every use of
5 the facts of the news that you're generating. You have
6 to have free riding by a defendant that actually
7 threatens the existence of the product itself, so does
8 that reach far enough to be useful to you?

9 MS. MALONE: That's exactly right, and I totally
10 agree. I think that a good -- if there is going to be
11 any federalization of hot news misappropriation, it has
12 to be very narrowly drafted. It has to absolutely
13 protect the kinds of things that we're talking about
14 protecting here, and it should not be a widely cast net,
15 and it needs to be as strict as set forth I think in
16 Motorola.

17 MS. MICHEL: Professor Benkler?

18 MR. BENKLER: Just a small point. The
19 narrowness of the doctrine is federalized. NBA versus
20 Motorola is a preemption case. That is to say, it's how
21 far can you go in a state without running afoul of the
22 patent and copyright, the exclusive rights clause and
23 the Copyright Act.

24 So the narrowness, and particularly that fifth
25 element of, you have to actually threaten with this act

1 the business model of the other, is considered to be
2 federalized and the limit, and there are very few states
3 that have hot news misappropriation, not in the context
4 of news, but in the context of exclusive rights to
5 databases, which was a massive debate in the '90s.

6 There has been a good bit of work on the
7 constitutional limits that the exclusive rights clause,
8 Article 1, Section 8, Clause 8, places on the ability of
9 Congress to do something under Article 1, under the
10 commerce clause, that would essentially do an end run
11 around the limitations within the exclusive rights
12 clause.

13 So it's not at all clear that what's federalized
14 here is the ability to expand the right as opposed to
15 the constraints on just how far, and that's before you
16 get the First Amendment questions, and although in
17 principle, the Supreme Court has been willing to extend
18 copyrights, even though it's problematic under
19 contemporary First Amendment doctrine.

20 The core argument there has been, to the extent
21 that it's existed, not the right to use somebody else's
22 words. It's a very different animal when you say in
23 order to preserve a public good, in order to serve the
24 public welfare, we, the government, will prohibit you, a
25 person, in your own words describing a truthful fact

1 over the limitations of the First Amendment, very
2 problematic, not at all clear that you want to be in a
3 universe where you, news organizations, are arguing that
4 the First Amendment can allow the government, in the
5 public interest of expanding welfare, to say to someone,
6 You may not report in your own words a true fact because
7 if you do so, you will be undermining some global public
8 welfare concern that we have, the flow of use, very
9 problematic, both on Article 1, Section 8, Clause 8, and
10 under the First Amendment.

11 A good bit of this work was done in the context
12 of databases where the First Amendment argument was less
13 central, although also important, and the exclusive
14 rights clause played the larger role.

15 MS. MICHEL: James?

16 MR. BOYLE: I think that the constitutional
17 issue is a really interesting one, and I would be happy
18 to get into that. I don't know how deep you want to go
19 in to it, but I think there is a fascinating
20 constitutional question here, and I agree with Yochai
21 that the database legislation is an interesting
22 precursor.

23 I do think it's just worth stepping back, one
24 thing that I like to do is just reflect how wrong I have
25 been about my confident projections about technology and

1 law in the past because I find it a useful corrective.
2 Like if someone had told me in 1990, What would the
3 model be for putting together an encyclopedia, one
4 person has a sort of Encyclopedia Britannica model, lots
5 of copyrights, lots of parts, lots of highly paid
6 editors, whatever, and another guy goes, Like I'll have
7 like a website and people can, like, put stuff up.

8 I wouldn't have thought that the latter was a
9 workable business model. I would have been wrong. I
10 wouldn't have thought that Linux Open Source was a
11 viable generation model. I would have been wrong, and I
12 think that the key here is permissions-based, and I
13 would separate James's and Ken's different solutions
14 slightly.

15 At the beginning of the net, it was an open
16 question whether linking would be permissions based or
17 not, speaking of the web I should say, not the net.
18 There were people who thought, wrongly I think under
19 American law, but who thought that there ought to be
20 permissions every time there was any link to anyone, and
21 still have people, mainly school districts, who write to
22 you saying, May I link to your website.

23 It's kind of like this is some lure that has
24 existed in school districts for some reason. It's sort
25 of like what people, ten year olds tell each other about

1 sex. There's sort of a continuing circle of
2 misinformation about copyright law that persists,
3 particularly in school districts.

4 Anyway, at the beginning of the Internet, if we
5 had been debating in this room, Hey, there's this new
6 web thingy, so should we be permissions based or should
7 we be kind of opt-in, opt-in or opt-out? We could have
8 come up with great reasons why everyone should have
9 permission. It's not that hard. You just have to write
10 to the person and get permission to link. It's not that
11 hard. If you want to create a match up on Google Maps,
12 you just have to write to all the data sources that
13 you're going to get, all million of them, and just get
14 permissions, it's not that hard.

15 All that would have prevented is the worldwide
16 web, right, but of course the people in this room
17 wouldn't have cared because they didn't know what the
18 worldwide web was and couldn't have imagined either its
19 horrific side, child porn, piracy which appears more
20 often than child porn, and Congress as one of its
21 horrific sites, child porn, sort of spam strangely
22 articulate Nigerian oil ministers who happen to write to
23 me personally.

24 So there's all the bad stuff, but there's also
25 this amazing world that is being built, and the point is

1 we would have got it wrong, dramatically wrong if we had
2 gone permissions based. Now, the good thing that we
3 would have foregone, we wouldn't have cared about
4 because we couldn't have imagined it. This for me
5 suggests humility as the guiding principle of
6 intervention?

7 So major changes, like going permissions based,
8 I just think that that is going to be so wrong in so
9 many cases with such tragic results that I would really
10 push against it.

11 There are actually sort of criteria that one can
12 work with to have the least harmful government
13 intervention, so acknowledge you're likely to be wrong
14 about the future of the technology. Acknowledge you're
15 likely to be wrong about the promise of the technology.
16 Jack Valenti said that the VCR is to the movie industry
17 as the Boston strangler is to the woman alone.

18 Within five years, it was 50 percent of their
19 market, so acknowledge that there are going to be
20 unintended consequences. The DMCA? A notable attempt
21 by content industries in some ways to protect their
22 online access to their stuff ends up being used by
23 people that make toner cartridges. You can't do this
24 because it's a violation of the DMCA. Garage door
25 openers, right? No matter how precisely we craft the

1 right, there are going to be unintended uses.

2 So I just think given all of that and
3 particularly given what we would have got wrong if we
4 had gone permissions based with the web at the
5 beginning, I just think that that is the real humility
6 with which we should approach this legally speaking, and
7 I actually think that humility has some constitutional
8 basis to it.

9 MS. MICHEL: Let's talk about then some of the
10 legislative ideas that have been proposed for the hot
11 news doctrine with the thought of humility and where it
12 might go. There's been proposals to perhaps clarify
13 that the hot news doctrine has not been preempted by
14 copyright law generally.

15 First I would like to know: Does anyone think
16 that this preemption issue is actually a problem for
17 bringing cases? Is it necessary to have this kind of
18 clarification through a statutory basis?

19 Another issue that's come up is: Should hot
20 news doctrine be federalized because it is a state
21 claim? Should we have a federal statute? Would that be
22 helpful in bringing cases? Would it limit our abilities
23 too much to use facts, and also any thoughts about just
24 the concerns that might surround opening up the
25 legislative process?

1 Laura, do you have any thoughts on, in
2 particular, legislation and whether it would or would
3 not be useful in this area?

4 MS. MALONE: We rely on it on a state by state
5 basis. We're lucky though, we're in New York, and we're
6 able to know that hot news misappropriation is there.

7 I think the reason for federalizing it, one of
8 the most compelling reasons, is so that there is some
9 guidance from state to state, so that there is
10 uniformity from state to state on exactly what hot news
11 misappropriation is or is not.

12 I think to that extent, it's probably very
13 helpful. Then you don't have to rely on what an Oregon
14 court is going to say compared to a Michigan court or a
15 Florida court. When they're relying on their own line
16 of cases, their own common law line of cases, then they
17 could get very different results, so I think in that
18 way, it would probably be good to federalize it.

19 MS. MICHEL: The preemption issue, how much is
20 that a concern to you?

21 MS. MALONE: Not. Yeah, it's not a concern to
22 me.

23 MS. MICHEL: Bruce, any thoughts on this?

24 MR. SANFORD: My partner, David Marburger, and
25 his economist brother have written a lot on that, and

1 they believe that it would be useful to clarify the
2 preemption issue, and they also believe that common law,
3 state by state development would be one way to go.

4 I think I come down on the side of the
5 usefulness of the discussion of a federalized law
6 because what the chief objective here is, it seems to
7 me, is getting fair and reasonable compensation to
8 content providers and moving to what Jim calls the
9 permission based economy.

10 The question really is fair compensation for
11 content. Newspapers do not have an audience problem. I
12 think Hal's charts showed that. They have a revenue
13 problem, and I think what this legislation should be
14 designed to do is to address what your workshops do, and
15 that is: How can we adjust laws in an era where
16 journalism and content needs more of an economic
17 funding?

18 There is no silver bullet in any of these laws,
19 I think we all agree on that, to solve the revenue
20 problems, but it can make a material, incremental
21 helpfulness, and that's the chief reason for doing it I
22 think.

23 MS. MICHEL: James?

24 MR. BOYLE: I do think, I just stress and I
25 really commend you, I haven't looked at the second day

1 of the workshop because sadly enough I'm not going to be
2 able to be here for it, but to look at the full range of
3 possible interventions that the government and the FTC
4 might make and really weigh costs and benefits.

5 There is a persistent I think mistake that
6 people begin with, Well, we're just seeking enforcement
7 of existing law. Well, this stuff is ours, it's ours,
8 right, and so we want to just protect our existing
9 rights, but of course to the extent it's just protecting
10 existing rights, then protect the existing rights.

11 To the extent it's not protecting existing
12 rights but actually creating new ones, federal ones, I
13 think that we really have to weigh the costs of this
14 intervention, some of which are unknown, the benefits
15 which are unknown as against the alternatives, and there
16 I think there are a great number of alternatives to be
17 considered.

18 I have to say, and I speak as someone who, I've
19 written in and been paid by the existing media, and I
20 think I'm probably more likely to be directly paid by
21 them than future models which are being developed, so
22 I'm a loser on the net net exchange, but there really is
23 an episode of Boyle's law of technology, government
24 regulation is that there's a pervasive problem, which is
25 mistaking the current parties, who deliver a

1 particularly useful social service, for the social
2 service itself.

3 The people who sold whale oil for lamps could
4 well have come to Congress and said, Illumination for
5 reading is a valuable thing, these new fangled electric
6 light companies need to be put out of business, and that
7 would have been the wrong move.

8 I think that the hot news doctrine has real
9 negative consequences. Right now it operates as a kind
10 of insider's club. Much of what is done by newspapers
11 with each other is actually problematic under existing
12 hot news doctrine, but would never for a moment be
13 considered litigated.

14 So if somebody, if Woodward and Bernstein have
15 the scope, and the same day, those facts are taken out,
16 repackaged, put into a story in a competing thing, the
17 competitor newspaper is never in a million years going
18 to sue so as long as credit is given to The Post.
19 That's not what the doctrine says.

20 So the difficulty is as you look, -- you could
21 actually say, wow, if this practice would continue,
22 would it pose a threat to the existence of the model
23 itself? You could look at all of these things. Now, of
24 course, it's an insider world. People that work for The
25 Washington Post now work for The New York Times and

1 vice-versa. They would never sue each other. They have
2 extremely literate, wonderful general counsel who are
3 benign in most of the decisions that they make.

4 MR. RICHIERI: I'll take that.

5 MR. BOYLE: So of course they're not going to --
6 they generally, although they're not always on the right
7 side of the fair use issues, as a result we don't see
8 what could happen were these rights to be fully enforced
9 in a malign rather than a benign way, but as new
10 entrants enter the market, that gentleman's agreement
11 stops existing, and you start having people saying,
12 Well, I'm just not sure whether I want to go along with
13 that.

14 Then you could have people invoking these rights
15 in ways that I think newspapers themselves and their
16 successors would find profoundly problematic. I think
17 it's much better to focus on -- I think enforcing the
18 existing state rights to the extent they're useful,
19 great.

20 The idea of the federalization, when we know
21 what happens to intellectual property rights when they
22 get into Congress and it's not pretty, and we know the
23 special interests that come in and add things, and we
24 know, oh, let's just broaden a little bit for like real
25 estate prices, and I'm sure we can get something in

1 there for name your special interest.

2 This is a very dangerous process for us to open
3 up with the newspapers, and I agree being the most
4 appealing, the poster children, they actually do perform
5 a socially useful function. They have genuine concerns
6 about the business model. This is frankly the wrong
7 place to pursue those concerns, but I understand the
8 inclination.

9 I really fear what happens when you open that
10 up.

11 MS. MICHEL: Ken?

12 MR. RICHIERI: I just want to say, I think sort
13 of the club analogy is not a particularly good one here
14 just in the sense -- I think what Laura is talking about
15 and which does exist, there are entities, it's a totally
16 one way street. The entity exists to report on what The
17 Times is reporting right now. That's what they do.

18 Now, one could say, there's actually a copyright
19 solution to this, the collective copyright, and they're
20 making a judgment that anything we say is news and only
21 what we say is news is news. They're just taking it and
22 re-reporting it, but it's not a two-way street. It's
23 not that they sometimes do things that we take and
24 whatever. It's people exist solely sort of to report on
25 what we're doing, which truly is the situation that you

1 confronted with Headline News. Their day job was to
2 look at whatever AP said was news and to rewrite it as
3 news.

4 So I think that your analogy kind of falls apart
5 on that. Putting aside your point on whether the
6 legislative solution is the right solution, is it
7 different? It's a different problem you're solving for.
8 It's a different problem.

9 MS. MICHEL: Thank you. Well, in that kind of
10 circumstance where the user of the content is rewriting
11 the content so it might not be protected by copyright,
12 which only reaches expression, what kind of tools, do
13 you have tools other than hot news to reach that?

14 Jim, do you have any thoughts on that or is hot
15 news your main way to reach that problem?

16 MR. MARCOVITZ: I mean, I think you look at --
17 copyright I think is one tool to reach that. I think
18 hot news is another tool to reach that. I don't think
19 there's necessarily very many other tools in the arsenal
20 that will reach that sort of activity.

21 MS. MICHEL: Yochai?

22 MR. BENKLER: I think one of the advantages of
23 an administrative fact finding process of the kind that
24 you're engaged in is that you're not limited like courts
25 to looking only at unattractive defendants.

1 MR. BOYLE: An attractive, please.

2 MR. BENKLER: You're so much better at this than
3 I am.

4 MR. BOYLE: I'm from Scotland. We always focus
5 on the positive.

6 MR. BENKLER: I think that to describe the day
7 of a journalist or journalism today as one that looks
8 only to fully funded long trips and three months in the
9 hills of Afghanistan finding a Taliban fighter, whereas
10 everybody online just looks at what the Associated Press
11 says is news and copies it, it just profoundly misstates
12 the way in which -- it mischaracterizes the way in which
13 the ecosystem is developing.

14 Though you didn't say it, and I presume you
15 would resist my characterization of what you said, the
16 implication that the thing you keep focusing on is the
17 equivalent of a copyist spammer as opposed to
18 understanding, and again going back to what the -- if
19 not unintended consequences, at least not the
20 consequences about which we speak, looking at Wikipedia,
21 looking at things like Yelp, looking at the wide range
22 of models that have emerged, and there are different
23 spaces in the information economy, an ecosystem is
24 developing that includes all sorts of players.

25 When you emphasize the way in which a particular

1 doctrine will be used against a particularly
2 unattractive player, you understate the negative
3 implications for all of the other places where, as I
4 said, you're seeing the emergence of party presses, both
5 commercial and non commercial. You're seeing the
6 emergence -- they're not formal party presses. They're
7 mobilized, and in that regard actually imposing some
8 internal party discipline for better or worse, if you
9 like parties or not, but imposing some party discipline
10 on both major parties.

11 You're seeing the emergence of research centers
12 suddenly being able to be -- not only delivering one
13 little particular discrete paper once in awhile, but
14 actually being able to create blogs by people who maybe
15 read very different materials that become sources for
16 more sophisticated journalists to begin to read.

17 So all of these things will have to move from a
18 system that assumes that I can report the facts to a
19 system where I need to have special relationships either
20 in the aggregate or in the individual, and that puts a
21 damper. That's the point of losing the web, and I think
22 it's really important for this process, unlike a court
23 that doesn't have jurisdiction to look beyond the
24 attractive plaintiff and unattractive defendant, that
25 you look at the systemic effects and that you look at

1 how, given all of the players, the costs of all of these
2 other models will increase when you try to solve using
3 this particular problem, looking at a particular subset
4 of unattractive defendants.

5 MS. MICHEL: James?

6 MR. BOYLE: I would just like to say,
7 particularly to Ken and to Laura, if I may, I didn't
8 express myself when I was talking about the club. It's
9 this: Right now we don't understand the unattractive
10 things about the hot news doctrine because the people
11 enforcing it are people like you. You have the First
12 Amendment wired into your bones, and you are dealing
13 frequently -- so you're not going to enforce it in
14 unattractive ways.

15 I don't particularly like the sploggers either.
16 We might disagree about the particular legal resolution
17 that's appropriate. Let's take a concrete example.
18 Remember the sort of political activist film maker who
19 broke the Acorn story, said they would go in and they
20 would get them to say these terrible stuff on film?

21 So these people are highly politically
22 motivated. They do something very socially valuable,
23 which is they bring certain facts to light, but they're
24 probably not going to be repeat players. That's
25 actually -- indeed they aren't members of the club.

1 Now, imagine with a hot news doctrine in place,
2 so here's big news, this is really big news, and all of
3 you guys want to report it, rightly so, but now they're
4 saying, Actually I have this new federal hot news
5 doctrine, isn't it nice, it's really spiffy, and I'm not
6 sure, I think The New York Times are a bunch of liberal
7 milkshakes, and I think they're going to put a different
8 spin on it, they're going to say, is this really
9 representative of what the organization does, so I just
10 really don't want them getting access to these facts.

11 Now give them a legal club that allows them at
12 least to slow down your reporting, and time is of the
13 essence as the hot news doctrine makes clear. My point
14 is: You have all had a sense of how hot news applies
15 because the people enforcing it are the people whose
16 interests are broadly speaking socially congruent with
17 our social interest in access to the news.

18 That would not be the case in the new, brave
19 online world. That's my point, and that's why you too
20 should be more scared than I think you are about the
21 possible consequences because deep in your hearts, you
22 go, Come on, I'm not going to enforce this, these
23 academics make up these ludicrous stories, but I'm never
24 going to go out and do that. I actually largely believe
25 you, but that's not the point because it's not you I'm

1 necessarily worried about.

2 It's on the one hand the people who think, I can
3 get the real estate prices locked up so that people
4 didn't get immediate access to those, and that matters.
5 On the other hand, it's the people who are politically
6 motivated have broken a big story, and they want to shut
7 down access.

8 I could spin you 20 other parades of horrors.
9 The point is, once you acknowledge there are new
10 entities breaking the news, and we have to acknowledge
11 that, then you have to acknowledge that the rights
12 holders are not just you, and that they will use the
13 rights in ways that you, as well as we, will not like.

14 So I think that's the club point. I agree, it's
15 complete, they are parasites. Parasites occasionally
16 are useful.

17 MS. MICHEL: In our last five minutes, let's
18 think about search engines a little bit. There have
19 been some proposals that perhaps the caching activities
20 of search engines, the copying of a website in order to
21 index it, should be considered copyright infringement.

22 Reactions, either positive or negative, to? It
23 raises a host of questions. Is copyright infringement
24 now or should it be? What would be the implications if
25 it were? Bruce, I think you had some suggestions about

1 this.

2 MR. SANFORD: Well, that's the big elephant in
3 the room in the book publishers case again obviously,
4 and it's an open question, an unresolved judicial
5 question as to whether the search engines believe it is
6 not copyright infringement, and other people can argue
7 that it is, and it hasn't really been resolved.

8 Again I think this is an issue where it makes --
9 what is important is maybe a marketplace solution and
10 discussions between the search engines and people who
11 feel that what they've done is copyright infringements,
12 and that's what you see going on in the attempt to
13 resolve or settle the book publisher's case, which may
14 or may not be successful.

15 MS. MICHEL: Doesn't any market-based solution
16 rest on a foundation of some kind of intellectual
17 property right though?

18 MR. SANFORD: Yes, I think it does. The
19 question is whether the activity of the search engines
20 in caching and copying and then making some sort of
21 repeated commercial use of the material that they've
22 copied is whether they're going to have a fair use
23 defense or not, and the strength or weakness of that
24 fair use defense is obviously going to be dependent upon
25 the facts of the case.

1 What I think everyone believes it will turn on
2 is the repetition of the commercialization and the
3 substitutability of the usage and whether it's some
4 value of the content, of the journalistic content that's
5 being extracted by that process, and as I said, whether
6 it's book publishers or newspapers arguing it, that's
7 the issue for that case.

8 It is certainly one that can be resolved again
9 with the approach that England is taken by trying to
10 address these issues in a legislative format, and even
11 as one who said -- that copyright discussions of
12 amending copyright laws is tortuous on Capitol Hill, I
13 do not agree that's not a good reason to engage in the
14 legislative discussion and debate, healthcare debate on
15 Capitol Hill is tortuous.

16 Many legislative processes are tortuous. That
17 doesn't mean you shouldn't do them and have the
18 conversation about how copyright law should apply in a
19 digital and an online world or whether it should be
20 adapted judicially by courts, which may be far more
21 uncomfortable, as the professors have suggested, in
22 trying to take a 1909 and 1976 and other copyright laws
23 that really don't foresee the usage and apply them to
24 some specific fact situation.

25 So at the end of the game, I really think there

1 should be a legislative discussion about that.

2 MS. MICHEL: All right. James, one point I took
3 out of your book was that sometimes creating these kinds
4 of property right gives content producers control over
5 technology. Do you have any thoughts about that?

6 MR. BOYLE: I think so. There's a nice analogy
7 here that Larry Lessig points out, which is that in the
8 early days of aviation, property owners made the very
9 reasonable argument that under the real estate laws that
10 we had all learned in property law that your property
11 extends infinitely out from a point of the center of the
12 earth out to the furthest reaches of the universe, since
13 nothing greater than American property law could
14 obviously be imagined, no greater power.

15 So people started saying, These new fangled
16 airplanes, commercial airplanes can't fly over my land
17 because they're violating my property rights, and it
18 took the courts not very long to go, This would be a
19 disaster, right. The idea of this provisions based
20 system would be a complete disaster. We would lose as a
21 society, far far more than we could possibly gain.

22 Similarly, any system which makes it a copyright
23 infringement to index the web, let's start with indexing
24 it, copyright law is supposed to promote science and the
25 useful arts, any system that basically says that Hal has

1 to write individually to every web site and say, Hey,
2 guys can we index you, is a disaster for copyright, for
3 Article 1, Section 8, Clause 8. It's a disaster for
4 knowledge.

5 It makes the web effectively useless because you
6 simply -- the stuff there is, but you can't find it. So
7 an opt-in system is terrible. An opt-out system, which
8 we largely have through robots.txt has worked quite
9 well, and thank God, Congress hasn't got involved in
10 messing it up yet, though we can always look forward to
11 that with great happiness.

12 Then caching. Caching is more complicated,
13 though from a copyright perspective, there's a copy in
14 the indexing. It may be stable enough to be perceived
15 or seen if they wrongly decide cases of MAI is taken as
16 your basis for fixation, so copy is copy is copy, so to
17 us, it seems very different for the reasons that Bruce
18 said, because you're thinking about frequency of use and
19 suitability, whereas the copy for the purposes of
20 indexing is clearly not. It's covered by many things,
21 but including the Perfect 10 doctrine that Yochai
22 mentioned.

23 So what would we do if we got actually control
24 over caching? I do think that where the cache simply
25 becomes a substitute and the person effectively under

1 the guise of being a search engine simply takes it and
2 just offers it and says, I'm just going to feed you
3 this, in particular I'm going to feed you with my own
4 ads, then I think a fair use argument becomes much, much
5 weaker, so I agree with that.

6 So really again, unintended consequences is the
7 theme. I would like to say we could effectively end up
8 giving control over a technology, i.e. the technology of
9 the web, to a particular set of content providers in a
10 way that would be profoundly anathematic, not just to
11 journalism and the news but to the entire society.

12 So I think, thank goodness we didn't legislate
13 on this early and allow it to develop with this kind of
14 system that we have, and as soon as you start
15 challenging that major premise and saying property laws
16 evolve, unless people specifically waive them. Well, we
17 know what the current system got us. It got us the web.

18 You want to change that fundamental premise and
19 think that won't change the technology? I think not, so
20 that's where I would really be scared, even though I'm
21 perfectly happy to discuss much more narrowly tailored
22 specific solutions on how you -- what robots.txt does.
23 I think a lot of that is technical rather than legal,
24 and there are lots of things that could be done under
25 existing law and with existing technology, which

1 newspapers are now experimenting with.

2 This is the most vibrant time for business
3 experimentation in the newspaper world, which is the
4 last time you want to stand in and impose legal right.
5 Let's see what happens. Maybe the pay walls will work.
6 Maybe they won't. We don't know. Maybe these new
7 models will flourish. Maybe they won't. We don't know.
8 This is not the time to drop a new crystal into the
9 super saturated solution and see what excretes.

10 MS. MICHEL: This has been wonderful. We are
11 out of time. If any panelists would like to make a
12 final comment, please we welcome that.

13 All right. Well, thank you very much, and
14 please join me in thanking our panelists.

15 (Applause.)

16 MS. DESANTI: We'll start again at 1:30.

17 (Whereupon, at 12:00 noon, a lunch recess was
18 taken.)

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1 AFTERNOON SESSION

2 (1:33 p.m.)

3 MS. DESANTI: This afternoon we're going to
4 begin with the possible use of technologies to lower the
5 cost of journalism. We heard about the revenue problems
6 this morning and ways maybe to increase revenue. This
7 afternoon we're starting with: How might you reduce the
8 cost?

9 We're very fortunate to have with us to begin
10 Sarah Cohen, who is the Knight Professor of the Practice
11 of Journalism and Public Policy at Duke University,
12 Sanford School of Public Policy. Her research focuses
13 on methods and tools to reduce the cost and difficulty
14 of investigative and accountability journalism, and she
15 absolutely knows something about what she's looking for
16 because she was a reporter and editor at The Washington
17 Post for more than ten years, and she shared in the 2002
18 Pulitzer Prize for investigative reporting. Sarah?

19 MS. COHEN: Thank you so much for having me
20 here. The first thing is this is my first foray into a
21 forum like this. As a reporter, I don't think we would
22 have ever done this, so it's a new role for me, and I
23 really appreciate the Commission's interest in
24 accountability and investigative reporting and what I
25 would call broadly public affairs reporting.

1 I know that you all have been talking a lot
2 about business models and revenues, and as Susan said, I
3 am working more specifically on the cost of reporting,
4 and particularly the cost of discovering new stories
5 rather than the cost of producing them or putting them
6 online or distributing them.

7 As I started looking into this, I'm looking at
8 both technologies and ways that tools can be used that
9 are being used in other fields, like in homeland
10 security research and things like that, but I also came
11 to the conclusion that the single biggest thing that the
12 federal government could do in order to reduce the cost
13 of reporting is to simply improve the public records
14 implementation, what I mean by that, the Freedom of
15 Information Act implementation.

16 In my 15 years as an investigative reporter,
17 that process of extracting records from federal, state
18 and local governments is by far the single most costly
19 and difficult portion of accountability reporting. If
20 you can't get the records at all, you can't do the
21 stories usually, and if you have to sue, it will take
22 years and tens of thousands of dollars before you're
23 done.

24 So rather than kind of complain about this
25 system, which we tend to do when we get a lot of

1 reporters together, is all we do is complain to one
2 another about them, I wanted to suggest some specific
3 steps that could be taken to reduce the cost and
4 difficulty of that side of the reporting equation.

5 I'm not saying that there hasn't been any
6 progress over the last year. I think a lot of people
7 were very optimistic when the new administration arrived
8 with a transparency agenda, but it's been slow, and
9 institutionalized secrecy is something that is going to
10 take a very long time to change.

11 One of the first suggestions that I had was to
12 institutionalize the release of very common
13 accountability records, and what I mean by that is
14 records that are used to monitor agency activity. These
15 are almost never available without a Freedom of
16 Information Act request, and they often take months
17 before they are released. Things in this category
18 include things like audits of grants, calendars of
19 cabinet and sub cabinet level officials, correspondence
20 logs, FOIA logs themselves and personnel records of
21 political appointees. These are pretty basic records
22 that every time they've been litigated, they've been
23 shown to be public, and they're very difficult to get.

24 1996 E-FOIA law required that agencies post on
25 their website something called their major information

1 system reviews, and this was geared at the idea that
2 before you can ask for a record, you have to kind of
3 know what's being kept and how, and very few agencies
4 have updated these major information system descriptions
5 in a long time, and when they have it's a very
6 unfortunate thing.

7 It's just a small little omission that makes it
8 incredibly hard to use. There's no date on it, so you
9 have no idea whether these are ten-year old information
10 systems or whether they're current, and there's no
11 contact names so you don't know who to call to ask.
12 It's a very small thing, but it can send you right down
13 the wrong road very quickly.

14 One of the biggest things that I've seen work in
15 especially the state of Florida 15 years ago or so is to
16 require building openness and transparency into every
17 new information collection and every new retooling of a
18 system. I don't know whether it was a law or a policy
19 or a practice that changed in Florida, but about 15
20 years ago they started doing this.

21 They did things like in a contract clearly
22 distinguishing what was commercially secret and what was
23 available to the public, and in a database, they made a
24 huge effort to avoid the use of proprietary or private,
25 unique identifiers like a Social Security or a DUNS

1 number, and for every new system, they built in how are
2 you going to extract this for the public when you need
3 to, even if wasn't intended as a public system.

4 Some of the systems in government that are
5 incredibly hard to extract information from for the
6 public are very simple. They're things like Email
7 systems that are almost impossible to search in most
8 agencies for public records, and contracts and grants
9 routinely commingle proprietary information, and
10 databases throughout the federal government are using
11 something called a DUNS number in order to identify
12 organizations, which is a proprietary code that can't be
13 shared with the public in full.

14 Other things that were done there that helped
15 were things like splitting fields so that the public
16 portion could be extracted. A simple example of that
17 would be to distinguish the five digit Zip Code from an
18 address field or to split out a date of birth into the
19 year, month and day so that you don't have to get
20 somebody's date of birth in order to get something about
21 the age, things like that.

22 The last way that this could be
23 institutionalized is to work it into OMB's review of
24 information collections. I believe every three years,
25 every information collection has to go through a review

1 of OMB, and I believe that there's a fairly extensive
2 list of requirements to make sure that it's secure, make
3 sure the private parts are private, make sure the
4 national security parts are secure.

5 And those are great priorities, but I don't
6 believe that there is a similar requirement that the
7 open parts be open. That may be one way to
8 institutionalize these issues so that in the next
9 administration, it won't take a sympathetic
10 administration in order to keep open records open.

11 Another series of things that could help on
12 these issues is to remind those who do business with the
13 government that their information is subject to Freedom
14 of Information Act requests. We're now running into a
15 series of issues where requests for records are sent
16 back to the original person or the original company for
17 their permission to release the records. That's really
18 new, and it's not something that was ever anticipated, I
19 don't think, in the law.

20 There's another piece of this that's a
21 recognition that for most reporting, it's state and
22 local records that are the most important, not
23 necessarily federal records, and I know when I was
24 working on some stories at the local level, for
25 instance, child deaths in Washington, D.C., the way that

1 we got records on those deaths was because a federal
2 grant that the District had taken required that the
3 District make certain information available about the
4 results of what had been funded with federal money, and
5 making sure that some of these grants that are given out
6 also include requirements for state and local
7 governments to also include the transparency, and that's
8 especially true since state laws differ so much on
9 public records.

10 The last thing is to have a clear path to
11 resolve issues. There is now, and I believe people are
12 calling it the Omblitzman's (phonetic) office and the
13 National Archives, the Office of Government Information
14 Services I believe, and that may show some promise in
15 having a way to resolve disputes without going to court,
16 and that would be a useful way to be able to do it.

17 There's another set of things that could help
18 preserve some of the accountability reporting, and this
19 is the more technological side of the equation. In
20 general, academia has not done much in journalism to
21 really move it forward. It has not been a leader
22 traditionally in the field of journalism. It's been a
23 follower, and most change in technological advances have
24 come from the news room up and then out into academia.

25 That is changing very rapidly. There is no

1 investment going on inside news rooms anymore, and I
2 think the academy is beginning to step up and try to
3 look at research that can be done.

4 In that vein, some of the things that the
5 federal government funds in other realms might be useful
6 for journalists but are not always easy to get ahold of,
7 and what I mean by that is software that is developed
8 under federal grants are often awarded copyrights, and I
9 understand the need to attract developers to create
10 software for the government or software for research,
11 but there may be some way to build in encouragement to
12 either give it away for free or to open source it for
13 public activities and to include journalism under the
14 rubric of a public good in that sense.

15 The same thing is true with federal facilities,
16 federally funded facilities. I know there's basically a
17 super computing center in North Carolina that's largely
18 state funded, not federally funded, that is not allowed
19 to let any commercial activity go on on their premises
20 or that are using their facilities, and what that does
21 is it precludes the ability to use some facilities for
22 things like optimal character recognition of large
23 document collections, which might take my little laptop
24 and most of the computers that are inside a news room
25 four or five days to recognize a 10,000 page document,

1 but a much more sophisticated computer set up might help
2 with that kind of thing.

3 The last thing that I wanted to mention, and
4 this may seem a little self-serving given my current
5 job, but is also to consider whether or not journalism
6 is a public good. It might be worthwhile to start
7 funding research into it the same way research is funded
8 into history or social sciences or other activities
9 inside the academy, but I understand that idea, that
10 it's a hard thing to envision what kind of research we
11 might do.

12 Right now what we are trying to do is to latch
13 on to some of the research that's been done elsewhere.
14 As an example, one piece of software was recently done
15 using federal funds that is a way for federal agencies
16 to look at comments and regulatory activities, and it's
17 a very sophisticated text mining operation, but it's not
18 available for reporters to look at things like similar
19 documents in state and local government, and it's owned
20 by two universities and copyrighted and so it's not
21 available for general use.

22 So that kind of research into how to deal with
23 large collections of text, how to take notes, how to do
24 a whole lot of things that journalists do everyday has
25 never been undertaken, and it might be time for that

1 kind of research to start.

2 That's what I have. Thank you.

3 (Applause.)

4 MS. DESANTI: Thank you very much, Sarah. We
5 really appreciate your willingness to join us for your
6 first foray, and I think the kinds of ideas that you're
7 coming up with, very practical nitty-gritty ideas, hold
8 some definite promise.

9 Now we're going to hear from Rob Atkinson, who
10 is the founder and president of the Information
11 Technology and Innovation Foundation, a Washington, D.C.
12 based technology policy think tank. He has an extensive
13 background in technology policy, has advised state and
14 national policymakers, and is a well known speaker on
15 innovation policy nationally and internationally. Rob?

16 MR. ATKINSON: Thank you. I was told this can
17 go up. Thank you, Susan. It's nice to be here. So I
18 want to also talk about this question, although I
19 probably will spill over slightly into this other
20 question of how technology can also lead to revenue
21 increases.

22 I want to start by framing this a little bit in
23 the sense of, part of the reason why we're having this
24 conversation is we're talking about a set of industries
25 in the economy, and in particular journalism here,

1 that's been transformed by ICT, and a lot of economists
2 call ICT what called a general purpose technology; in
3 other words, a technology that can be used across many
4 different industries for many different functions.

5 When you look at what's happened in the last
6 decade, we see industry transformations that are going
7 on in virtually every industry around a whole set of
8 similar processes that we're seeing in media, clearly
9 atoms to bits, in other words, moving to web delivery, a
10 whole set of financial institutions now, for example,
11 like I&G bank or E*TRADE that don't do any sort of paper
12 delivery anymore. There's no physical brick and mortar.
13 It's all web delivery.

14 Intense competition. One of the defining
15 aspects to me of the Internet economy is it allows
16 companies to get into other people's business, and so
17 what used to be relatively defined market segments are
18 now much more of the boundaries between them, there are
19 much more amorphous, and we certainly see that obviously
20 in newspapers with classified ads and other types of
21 business being competed away.

22 Third is consolidation. When the Internet first
23 emerged, a lot of people thought that it would have the
24 opposite effect. In fact, it's having the effect of
25 enabling consolidation because you can run things

1 centrally. You don't need as many disaggregated pieces
2 of that, and I think we will see that and we are seeing
3 that and will see that in newspapers.

4 Lastly obviously, disaggregation, the whole
5 notion of being able to bundle things together and take
6 various pieces out. If you think of sort of industries
7 that are transformed, one of the key things the Internet
8 does is it lowers cost, and for most industries that's a
9 great thing. It's like, wow, I'm going to lower my cost
10 structure 25 percent. Why isn't that positive?

11 In a lot of industries we see, it's very
12 positive. We see it in travel. We see it in banking.
13 We see it in retail. We see it in logistics where the
14 cost structure is down. Output is up.

15 I think the two industries that are closest to
16 news in this regard, one is the Postal Service. Mail,
17 if you will, we're going to call it, in other words,
18 things going between places are up by a thousand
19 percent. It's just that the Postal Office isn't getting
20 any of that business because it's going to Google or
21 other types of Email or things like that, so in that
22 sense it's good for the process. It's bad for the firm.

23 The other to me is music or new movies, the
24 ability to get digital content. Again that should drive
25 the growth of that industry because the cost structure

1 now of the music industry is much better than it was a
2 decade ago. You can lower your production and
3 distribution costs by anywhere between 30 and 40
4 percent. People ought to be buying more movies and more
5 music. They're not obviously because of piracy, so
6 obviously there are some industries that are able to
7 take digital transformation and the cost it manages and
8 grow with it.

9 I think the key question is: What's going to
10 happen with journalism? The Pew Project For Excellence
11 in Journalism stated last year: "Yet it is now all but
12 settled that advertising revenue, the model that
13 financed journalism for the last century, will be
14 inadequate to do so in this one."

15 I'm not sure that's true, and let me explain
16 why. I think it's not true for two reasons. One is
17 digital technology can lower cost and also increase
18 revenues. Let's just talk about lowering costs for a
19 minute. The reason why it's so hard I think for
20 newspapers is that what they're competing with right now
21 is not really newspapers. They're trying to get people
22 to go to this other device, this thing which really
23 looks and acting nothing like a newspaper.

24 It's an expensive device that I only have one or
25 maybe two of them in the home. They're not ubiquitous.

1 If this were a newspapers, I can carry it with me. I
2 can read it at my morning breakfast table, but what's
3 the real value of a newspaper? Clearly it's not the
4 pulp from the ground up trees that's delivered to my
5 house every morning. I don't pay The Washington Post
6 and The New York Times money for having them deliver
7 paper to my house. I pay them money to deliver
8 information to my house.

9 So in theory, one could imagine essentially
10 display technologies that replicate newspapers, so in a
11 way you could suggest maybe what we'll end up really
12 needing is not newspapers but news E-papers, and if that
13 were the case, then you could envision a world where we
14 don't have newspapers, we have news E-papers, and if you
15 do that, the cost reduction could be significant.

16 There are various cost estimates that are thrown
17 around. One a little bit dated that I found for that
18 news print and ink are that 14 percent of cost, more
19 than news and editorial production. Circulation costs
20 are 11 percent; production costs 8 percent, so the
21 suggested E-delivery could cost 30 or more percentage of
22 the cost structure.

23 There's a study by Thurman and Milotti out of
24 Finland that found when the Finnish Financial Daily
25 Talloussanommat cut delivery, I would say over 50 percent

1 of its costs were reduced by moving to a digital format.
2 Unfortunately 70 percent of its revenue was also reduced
3 because they couldn't get the same advertising.

4 The reason they don't get the same advertising
5 is because people spend a tenth of the time online with
6 the news than they do with a piece of paper, so I think
7 part of what we need to be thinking about is: How do we
8 get display technologies that let people spend 25
9 minutes a day on a news E-paper? I think the entire
10 business begins to change there.

11 I remember four or five years ago people saying
12 to me, when I was advocating that E-books would be a big
13 thing in the future and ultimately would eliminate paper
14 books, people would say, Oh, come on that's not going to
15 happen, four or five years ago and people said that.
16 Look at where we are today. We'll have probably around
17 7 million E-book readers sold this year. Obviously the
18 Kindle, but the other readers of the iPad, Apple's iPad
19 coming out in a few weeks.

20 These to me would be what I would call stage one
21 readers. They're certainly more convenient than having
22 to carry around a laptop or a desktop. They certainly
23 could, in some way, substitute for the paper portion,
24 but I think the real sort of promise is in the next
25 generation of these technologies, flexible display

1 technologies, essentially things that look like this and
2 feel like this that have the feel of paper but are
3 essentially just bit display devices.

4 These technologies, at least according to some
5 engineers I talked to, a couple years away from
6 marketplace emergence and even pretty interesting
7 technologies. Arizona State University, they have a
8 flexible display center. They're working with HP and
9 some other companies. They've developed a touch screen
10 active matrix technology like this. It's like this,
11 only you touch it, and it responds just like you would
12 on touching a screen on your iPod, let's say.

13 So those technologies suggest to me that at some
14 point in time, it will get a lot more like reading a
15 paper, and as a result of that, people will be spending
16 more time, and as a result ad rates could go up. You
17 could envision getting rid of paper production
18 completely and still getting the paper experience.

19 Another technology that people don't talk about
20 but it's surface computing. Microsoft has developed
21 this. A couple of other companies are working on it.
22 Service computing is essentially a table that is a
23 computer service. You touch it. Things come up.

24 You could envision a surface dining room table
25 where my wife is over on her side reading the style

1 section, and I'm reading the sports section over here,
2 and my son here over is reading the business section,
3 all on the same dining room or kitchen table. That
4 technology is there today. It's a little pricey, but
5 with more time, one would assume the price is going to
6 come down.

7 I think even more interesting are the whole
8 notion of surface projection. MIT media lab is working
9 on this where you could project right on the wall, so in
10 other words, you don't have to -- you can project it on
11 to almost whatever you want; in other words, a picture
12 of the newspaper and just touch something and wave your
13 hand and the wall changes, so you don't even need an
14 active display. You can just use passive displays like
15 we have all around us.

16 So I think those technologies are going to come.
17 I think the real question to me is: Will the newspaper
18 survive long enough before the saviour of new displays
19 emerge? It would be interesting if we actually flipped
20 it around, if the Internet was going to emerge in 2020
21 and flexible displays emerged in 1995, we would probably
22 be talking about the golden age of media right now
23 because their costs would have gone down 35 percent, and
24 their readership would have stayed sort of constant.
25 Obviously we're the other way.

1 By the way, one other nice piece of this, by the
2 way, according to a report that we did and looked at
3 research on this, reading a newspaper on a display like
4 that reduces carbon by 32 to 140 times less carbon
5 emissions into the atmosphere than getting your
6 newspaper delivered to your home.

7 So as I said, one of the advantages if people
8 can start reading news E-papers, you could imagine
9 advertising revenues increasing by a factor of five,
10 even ten fold because of the amount of time spent
11 sitting there and reading them. It would go up five to
12 ten, even fifteen fold.

13 I think the second piece of this is when
14 economists talk about cost reduction, but it's in the
15 context also of quality, so if quality goes up and the
16 price stays the same, that's essentially a cost
17 reduction to an economist, and I think we have to talk
18 about the fact that there are technologies now that are
19 going to allow what you would call mass customization of
20 the news.

21 Obviously the Internet is doing that. You can
22 get a site customized to you with your interest in news.
23 What I think is interesting and I don't think a lot of
24 people are aware of is we're beginning to see that in
25 paper, so historically if you wanted to have paper

1 customization, in other words, a magazine like Newsweek
2 or Business Week, if they wanted to customize it, they
3 would have to essentially print it with a digital
4 printer, very slow, very expensive, and instead they use
5 offset printers for very fast, very cheap. The only
6 problem with offset printers is they'll print off
7 200,000 copies of Business Week, and each copy will be
8 exactly the same.

9 Now, what's interesting is that at least one
10 company that I'm aware of, Kodak, has developed new
11 digital printing technologies that have more or less the
12 speeds and quality and cost structure of offset, but
13 with the customization of digital. Kodak calls their
14 technology Stream Technology.

15 The advantage of that technology when you think
16 about it, it's not at the newspaper level, but it's
17 certainly at the magazine, so we're talking about
18 magazine journalism. This to me is a potential, very
19 important breakthrough technology because it would allow
20 Newsweek to produce 400 or 500 or in theory a hundred
21 thousand different Newsweeks every week. I could tell
22 Newsweek that I'm more interested in international, and
23 I'm particularly interested in military affairs, and I
24 would get a few more stories on that, and I would get no
25 stories about wine again in my Business Week, which I

1 find a total waste of time, why I'm reading about wine
2 in Business Week. In other words, you can mass
3 customize Business Week, Newsweek, Time, these sorts of
4 things.

5 If you do that, obviously the value to the
6 customer is greater. They're more likely to subscribe.
7 They're possibly even more likely to pay a little more,
8 but you also get cost reduction, so one of the problems
9 with magazines right now is that you have to shift them
10 somewhere, and since you have economies of scale, you're
11 weighing that against distribution costs that tends to
12 be, you print a lot in one place and ship long
13 distances.

14 This technology in theory, you could imagine
15 that every major postal regional station like the one
16 out in Manassas, every major metro area has a printing
17 facility right located a hundred yards from the Post
18 Office, and Newsweek is printed in Columbus, Ohio, and
19 it's printed in Cleveland and in it's printed in
20 Indianapolis and it's printed everywhere, as is Business
21 Week as are all these others, and they're just mailed,
22 if you will, that very short distance, and with mail
23 rates being a significant component of that cost, you
24 end up reducing cost of that.

25 Let me just close by saying the other advantage

1 of all of that is on the revenue side. Clearly mass
2 customized newspapers could have mass customized ads, so
3 I can tell Business Week that I really like big and tall
4 clothing, and they could give me big and tall clothing
5 ads, and as a result, they would get more money for
6 those ads. So I think this notion that if you get more
7 customization there, you will also get more revenues in
8 addition to lower costs.

9 Lastly, what are the policy implications of
10 this? I know this is the FTC and not the National
11 Science Foundation, but it strikes me that certainly a
12 policy step that the federal government could take would
13 be to do a lot more support of display technology R&D.
14 We have a couple centers around the country that do
15 this. They're relatively underfunded.

16 This is an important technology not just for the
17 news business or the news industry but for a whole set
18 of other applications throughout the economy, and better
19 displays that are more clear, more flexible, et cetera,
20 more portable would help not just the news industry but
21 the overall economy so that would be one sort of simple
22 thing the NSF could fund there.

23 I think the second thing, next Tuesday or next
24 Wednesday we'll be hearing about the National Broadband
25 Strategy that the administration will be unveiling.

1 Clearly there I think is an important area. If more
2 people are online, if more people are able to get their
3 news online, that's certainly going to help on the
4 revenue side, but ultimately also to allow newspapers to
5 get rid of paper. That's one of the things that is
6 holding that back to some extent is that not everybody
7 uses digital means.

8 Lastly, again more on the revenue side, I think
9 it is important to think that certainly some efforts on
10 privacy might go slightly in the opposite direction. We
11 do want newspaper publishers to be able to maximize ad
12 revenue I would argue, and that means getting better
13 information about users will help do that.

14 So let me just close by saying, I did a little
15 calculation looking at current revenues of the news
16 industry, the newspaper industry, and where they are
17 today. If web ad revenues grew 22 percent every year,
18 which you might think is excessive but I think it's
19 actually probably reasonable if you were to shift to
20 these other types of technologies, and costs were 70
21 percent of where they are today, which I think is again
22 pretty cautious, in a decade, revenues would exceed
23 costs. Revenues would exceed where they are today.

24 So in a lot of ways I think what we are talking
25 about is a decade of uncertainty, but potentially

1 technology could play an important role in a sustainable
2 future so thank you.

3 (Applause.)

4 MS. DESANTI: Thank you very much rob. I
5 continue to be surprised when I shouldn't be that every
6 speaker comes up with new ideas that we in fact haven't
7 heard before so thank you very much for your
8 introduction of more new ideas.

9 Now, we are venturing into the area of corporate
10 law and tax law with a great of trepidation but
11 nonetheless this is an important area in which some
12 proposals have emerged so we need to understand it.

13 The basic idea underlying this discussion will
14 be how to create a hybrid nonprofit, for profit entity
15 that serves a charitable purpose, and can operate
16 consistent with all the relevant laws, such as tax and
17 corporate laws, and most particularly can be tax exempt.

18 In our case we're looking at journalism as
19 possibly fulfilling a charitable purpose, but this
20 movement towards social purpose entrepreneurship, that
21 is, finding a way to combine nonprofit funding
22 from commercial investors to achieve a specific
23 charitable purpose, that movement is far broader and has
24 many more applications than simply in journalism.

25 Today we are going to start with three

1 presentations that give us different perspectives. The
2 first two will address particular models that have been
3 created, and the third is going to broaden our horizon
4 so we can see the wide variety of institutions that are
5 relevant to this movement towards social purpose
6 entrepreneurship.

7 Our first presentation will be from Bob Lang,
8 who is the CEO of the Mary Elizabeth and Gordon B.
9 Mannweiler Foundation and the CEO of L3C Advisors L3C.
10 He's responsible for many innovative projects, such as
11 the L3C, which is a new legal structure designed to
12 incorporate socially beneficial activities under a for
13 profit umbrella. Bob?

14 MR. LANG: First off, I have to say that the
15 last speaker mentioned certain types of paper, and in
16 the interest that you've always expressed, we have to
17 have all sides, I want you to know we've done a survey,
18 and parrakeets are 100 percent against E-paper, and
19 fish. Fish also have definite objections.

20 Why are we here? In a way we're here because
21 everybody seems to say out there someplace, journalism
22 will rise again like the Phoenix, but in the meantime
23 journalists have to eat. Journalists have to survive,
24 and people have to keep on getting their information
25 because in a democracy, if we don't have the

1 information, we can't make good decisions.

2 So I think one of the reasons we're talking
3 about, whether it's the L3C or a myriad of other
4 structures in the hybrid space is because we're looking
5 for something where we can mix new forms of investment
6 that may be less profit driven, to the extent the
7 present newspaper's running. A few years ago, a
8 newspaper could return a 30 percent return. It became a
9 Wall Street play. Let's see if we can merge it with
10 three others, and three others, and we can build a
11 conglomerate, and nobody paid attention to what was
12 happening down in the news room level.

13 So what we're trying to do with the L3C is not
14 just newspapers, we're working in a lot of space, and
15 the L3C-- first of all, I would like to put a few myths
16 to bed here because a lot of people have come up with a
17 lot of mistaken ideas about the L3C.

18 First off, we are not proposing it as the cure
19 all for everything. There's room in this space for B
20 corporations. There's room in this space for a whole
21 lot of other things. There are two gentlemen sitting
22 here, Allen and Ron, who are basically agnostics who
23 will keep looking forever for a dozen different ways.
24 Out in California, they're talking about something
25 called the flexible corporation, and that has a lot of

1 very interesting aspects, and it's a totally for-profit.
2 There's no hybrid purpose. They're all in the flexible
3 corporation, but the idea is that there are investors
4 out there who will put their money into something that
5 is socially beneficial, even if they don't make as much
6 money.

7 So what we did with the L3C is we said there's
8 an intersection point. If you look at your spectrum
9 along the line of investment, there's such a thing
10 called nonprofits. These basically cannot earn their
11 own keep, so they take donations every year from people,
12 so that's the minus 100 percent. Foundations come, give
13 grants, complete loss of the grant money. It's gone.
14 It's out the window.

15 Now, somewhere up -- and the number depends upon
16 the risk, and I'm not going to try to cut a hard line,
17 but it often relates to what, in normal times, you can
18 get on short-term treasury notes or other types of
19 paper. Somewhere above 5 percent commercial investors
20 will take on different kinds of investment, in between,
21 things that will only make 1 percent, 2 percent, 3
22 percent, 4 percent.

23 It's a big gap. It's a losing piece of
24 property, but there's an awful lot of social enterprise,
25 if you will, that can earn and sustain itself within

1 that space. What's its problem? It needs working
2 capital in order to survive because if you and I go out
3 to set up a business, we normally try to figure what we
4 need to operate it. We need to figure out -- we need to
5 go on, if things are bad, things are good.

6 Usually a lot of times there's formulas, let's
7 have a year or two years' worth of money in the bank
8 before we start our business if it's a new area, so how
9 does a -- in business, once the operators is in the
10 space where it can't normally get money from commercial
11 investors, get the money to create the working capital
12 to operate?

13 Well, let's back up into something. First off,
14 private foundations are, for all intents and purposes, a
15 closed-in investment trust. Now, when they were first
16 set up, basically people got tax credits for donating
17 their money to a foundation, and the foundation pretty
18 much did whatever it wanted with the money. A lot of
19 them were set up by families that wanted to keep control
20 of a family business within the family, so they set up
21 foundations. The kids kept running the business. The
22 family ran the foundation. There were all sorts of
23 little deals going on.

24 Somewhere around 1969, Congress begin to look at
25 this and said, This just isn't Kosher, we're just

1 basically creating a class of privileged people here
2 that don't -- that get a tax deduction and go on about
3 life. So they passed a whole set of regulations.
4 Private foundations have to now give away 5 percent
5 every year of their asset value within -- I won't go
6 into the details of that.

7 When creating that, some very smart lawyers from
8 Yale, John Simon and a few other places said, Wait a
9 minute, sometimes you can take foundation money and put
10 it into a for-profit, even if it's a risky venture, and
11 you can do a lot of good with it. For example, and it's
12 been done over, Gates is doing it now. Gates gives a
13 grant to a wealthy pharmaceutical company and says, But
14 you have to use this grant. It's a grant, not even an
15 investment, just a grant and says, You have to use this
16 grant to develop a drug for a particular say left-handed
17 hangnails and there's not enough people to worry about
18 left-handed hangnails.

19 So Gates gives it, and this is a legal use of
20 grant money. There's no question. There's no issues
21 involved, so they said, Why don't we create this thing
22 called PRIs, program related investments. Program
23 related investments would be investments that are the
24 opposite of what you should normally do with your
25 endowment.

1 There's all sorts of prudent investor rules for
2 foundation endowment and all sorts of penalties against
3 because that's another part of the regulations that came
4 in that said, Wait a minute, you can't just play fast
5 and loose, you've gotten a tax deduction for this money,
6 there's a public trust involved in this money so you
7 can't play fast and loose with it anymore.

8 But you've taken your little 5 percent, and
9 you're giving it away. There's no greater risk.
10 There's no smaller return. I mean, you essentially walk
11 over to the window, take the envelope and throw it out
12 and whoever catches it has got a grant, so why not say
13 we could take this 5 percent and invest it in a for
14 profit if, and this is a big if, it actually was the
15 opposite of what a normal endowment investment is.

16 It has to be a high risk or it has to be low
17 return or it has to be some blend of the two, and it has
18 to perform the same kind of charitable purpose that a
19 grant performs because remember we're replacing a grant.
20 We're not giving you a bye to play some game. So this
21 tool was created. The only problem was no vehicle was
22 ever really created for this tool.

23 Now, there's a great vehicle for most of what
24 the foundations grant. It's called a 501(c)(3), take
25 your form, fill it out, fill in the blanks, send it to

1 the IRS. They have a factory in Cincinnati, that I
2 believe, I don't know, is it 75,000 a year or something
3 papers that you guys process down there for review,
4 whether or not to grant 501(c)(3) status?

5 This form, you got a good attorney, you fill it
6 out right. It's basically promises to keep. You stay
7 within the guidelines and the rules that the IRS has
8 prescribed for a nonprofit, and a few months and a few
9 dollars later, you'll get back your little thing with a
10 rubber stamp so to speak that says, You're now a
11 501(c)(3).

12 Now, that's created a safe harbor, if you will,
13 for foundations because if in compliance with their
14 mission, they gave their money to a 501(c)(3), it had
15 been more or less IRS pre approved. Okay. This is
16 easy, so 95 percent of the foundations never made a PRI.
17 Why should they go to the extra trouble when 501(c)(3)s
18 exist?

19 Well, the problem is that, remember we have this
20 space in here where a lot of things could work, where a
21 lot of the social enterprise would work, where a lot of
22 alternative energy, you name it, the Moo Milk up in
23 Maine saving a bunch of farmers that otherwise would go
24 down. These things could work if we could find ways to
25 bring investment dollars into the space.

1 So when I started looking at this space, I said,
2 Well, the end -- Allen here, who I'm going to give you
3 the credit because this is the man that actually said to
4 me, Make it an LLC if you're going to make it anything
5 because LLCs have great flexibility in organization, and
6 the organizational ability of that allows you to have
7 greater opportunity.

8 All right. That makes sense, so I created the
9 concept of the L3C. We looked at the PRI regulations,
10 and we said, We really want to conform with those
11 regulations. Why? Because we want to be able to make
12 it easier to form a vehicle in this space.

13 Now, you've always been able to take an LLC and
14 organize it with an operating agreement and basically go
15 to a foundation for a PRI. It could always be done, but
16 they were one offs. People don't like one offs in many,
17 many spaces in this country.

18 One of the reasons for the flexible purpose
19 corporation in California is that they are -- they're
20 going to keep it a purely for profit corporation, but
21 one of the reasons that they will tell you is that the
22 investment community is uncomfortable with inconsistent
23 vehicles. They like the corporation because they know
24 what a corporation is, and they can sell shares in the
25 corporation. It's a good, easy way to raise money, and

1 it's true, corporations still go public more often than
2 LLCs, although that's changing, but a corporation is
3 still the form for a public entity.

4 So we said at least we can in this space make it
5 easier for people by coming up with a recognized name, a
6 brand, if you will. Coca-Cola is a lot easier, you know
7 what it is. You want a Coca-Cola, you go out and buy
8 one. You don't have to go in your kitchen and get out a
9 bunch of stuff and see if you can match some sort of
10 flavor and come up with your own Coca-Cola.

11 It doesn't eliminate any of the regulations. It
12 doesn't eliminate any of the purposes of the IRS or any
13 of those state regulations. In fact, one of the rules,
14 when I got ready to set this up, was that I have to find
15 myself an attorney that fully understands the regs so,
16 A, we do no harm and, B, we comply with all the regs.

17 So we hired Mark Owens of Caplin and Drysdale,
18 who I think was 25 years experience in the exempt
19 division, ten years of it running the exempt division,
20 certainly understood how to write our laws in such a way
21 as to not, in any way, cause a problem, so he did, and
22 that's how we went off, and we started going to various
23 states and looking for states to pass the L3C bill,
24 which basically provided for all the provisions of the
25 PRI, which we don't have to go into the details. We can

1 talk about this again, basically just that it has to be
2 mission -- essentially what we wanted was mission before
3 profit, and we wanted the concept that had to be a
4 charitable purpose and it was in compliance with what
5 with the IRS would normally consider charitable.

6 So Vermont was the first state to pass the law,
7 and because we had grafted it as part of the LC statute,
8 which makes it a variable form of the LLC, it is now
9 legal in all 50 states. Although many people
10 don't understand this, I do not need to see another
11 state pass it tomorrow morning. We need to do no more
12 work at any level. Anybody who wants to form an L3C has
13 five states and two Indian tribes that they can go form
14 them in, and that's why we essentially spent no money
15 trying to pass the law in any other states.

16 Every other state where it's been passed or
17 where it's been worked on, I should say, it's been local
18 people that have this grass roots movement. They've
19 said, We want this and can you give us support material,
20 and we provide support material, but we do not expend
21 money to try to pass these bills.

22 However, we recognize that there are some tweaks
23 that need to be done, and we've said all along we're
24 perfectly willing to look at tweaks, look at changes,
25 but you have to start from someplace. There has to be a

1 beginning, and we made a beginning, and that's where we
2 want to take off from. We would like to see -- I
3 believe in the B corporation.

4 I think people have come to me and said: Can
5 L3Cs be B corporations? I said, Why not, if you feel
6 you need the double layer of branding, then go for it,
7 have fun, be a B corporation too. They're not mutually
8 exclusive, but the whole real idea underlying this is
9 funding.

10 Now, let's look at funding a minute. Let's
11 suppose that we're talking about this space again
12 between zero and 5 percent, so let's suppose that you've
13 got an enterprise that's a social enterprise that can
14 earn overall -- I'm going to make this simple. There's
15 a million permutations. Let's just make it simple. You
16 can earn 5 percent. Nobody wants to invest and give you
17 the working capital of 5 percent. It's not enough
18 return. You have a group of investors that say, Well,
19 if I can get 10 percent and have a little better
20 security, you would have my money.

21 Okay. So here's a simple construct. We go to a
22 foundation and we say to the foundation, You give us 50
23 percent of the money at no return, but you still own a
24 piece of it, and we go to private investors and say,
25 Okay, we can now give you the 10 percent on a more

1 secure tranche on the L3C because we didn't pay the
2 foundation anything, so the same pool of money now
3 becomes 10 percent for that group of investors, simple
4 construct.

5 This does not mean that it's a bad deal for the
6 foundation because the foundation still has certain
7 things. First of all, foundations now give grants, and
8 they really lose control after they give a grant. They
9 may tell the nonprofit what they want them to do with
10 the money, but other than the threat of no new money
11 next year, they're pretty limited on what they can
12 really do, unless they want to get into a really ugly
13 fight, but if they stay as part of an L3C, they can be
14 on a management board.

15 They can have -- however the operating agreement
16 is written, they can have controls, so they can ensure
17 that it's an ongoing enterprise that continues to do
18 what they want. If it's ever sold, if it no longer
19 needs to be an L3C anymore, the foundation can get its
20 money back. It can make a capital gain on it, all
21 perfectly legal. PRI rules have never said that they
22 couldn't make a capital gain. They couldn't make a nice
23 profit. It just couldn't be the original goal was to
24 make a profit.

25 So with this in mind, it's a better situation

1 for a lot of foundations, in certain kinds of things, to
2 basically not be putting money year in and year out for
3 support, but to be able to put up a certain amount of
4 money once and to support a certain amount of commercial
5 investment, and newspapers fit into this bill very
6 nicely because the L3C is a for profit vehicle.

7 Now, that's another benefit. With a million
8 eight hundred thousand nonprofits floating around, I
9 think you read the newspapers, a lot of towns, cities
10 and whatnot are getting tired of tax exemptions.
11 They're looking and saying, somebody else wants to open
12 a place and they want a tax exemption on their real
13 estate and they want a sales tax, what were we going to
14 use for money to support the city anymore?

15 In fact, I think Pittsburgh has gone through a
16 whole thing of trying to actually find some way of
17 taxing nonprofits, which of course is counterproductive,
18 but nonetheless there's the issue here. Well, the L3C
19 is -- okay, I like this. The L3C is a for profit -- I
20 have no idea how to operate it.

21 MS. DESANTI: They were supposed to fix this
22 during the lunch.

23 MR. LANG: All right. Anyway, this is now a for
24 profit vehicle, so if it makes a lot of money or even if
25 it doesn't make a lot of money, it's going to have to

1 pay tax on its real estate, and if it makes money as a
2 business, then we have a situation because all the LLCs
3 are normally pass-throughs where the money gets split
4 according to the operating agreement, with various
5 groups that may receive a profit and have to pay tax on
6 it, groups that may not pay a tax, like a foundation or
7 whatever.

8 So it's very flexible, very easy. With a
9 newspaper, that's just what we need. We need a for
10 profit vehicle because newspapers take advertising. We
11 don't want to get into arguments over UBIT and some of
12 these other things. The advertising, by the way -- does
13 that mean my 15 minutes, which I'm over, start over?

14 MS. DESANTI: No.

15 MR. LANG: Newspapers have a lot of things they
16 want to do, and by the way, the economic aspect of the
17 advertising in the newspaper happens to be the important
18 economic engine of a lot of smaller cities and towns, so
19 the economy might suffer more than the people if the
20 newspaper went down in some places.

21 I'm trying to finish. Susan says (indicating).
22 Next time she's going to get a big clock with a gong.

23 Anyway, so what they're trying to do is stay as
24 a for profit vehicle. Now, there are some minor issues
25 with whether or not having editorials is lobbying, and

1 the lobbying aspects of the IRS rules, and we are trying
2 to address that with a bill that we're proposing to
3 Congress, the philanthropic -- the Facilitation Act of
4 2010, which later on, Elizabeth, you can give them kind
5 of a run down of that, and that also will provide for a
6 registration process for PRIs, because PRIs in essence
7 are nothing more than the same thing that a nonprofit
8 is, is promises to keep, and it could be worked out and
9 registered in the same way with a little bit of
10 forethought.

11 The section on taxation of the American Bar
12 Association last week essentially agreed with us on all
13 points. They have issued an advisory that they're
14 asking the treasury to put into IRS examples that would
15 include newspapers. It would include equity kickers
16 within PRIs. It would include a whole wide variety of
17 activities that they have looked at what the IRS has
18 approved over the last ten years. They've looked at
19 private letter rulings, and they've said, You're doing
20 this anyway, let's put it in as an example.

21 They also said the L3C is a varying form of
22 LLCs. The IRS has long ago put to bed any idea that
23 there was anything wrong with LLCs for PRIs, so
24 therefore we don't even feel the need to go into PRIs --
25 so I mean L3Cs.

1 So that is it. Do you want to discuss this now
2 or later?

3 MS. DESANTI: No. We'll do it during the panel
4 discussion. Thank you, Bob.

5 (Applause).

6 MS. DESANTI: Okay. Our next presentation is
7 from William H. Clark, Junior, who's a partner at the
8 firm of Drinker, Biddle and Reath, LLP, as well as
9 counsel to B Lab. Mr. Clark is also the reporter for a
10 special committee of the American Bar Association
11 Business Law Section that is preparing a comprehensive
12 revision of the Model Nonprofit Corporation Act, and Mr.
13 Clark's going to talk to us about B corporations.

14 MR. CLARK: Thank you. Good afternoon,
15 everyone. My principal topic this afternoon is actually
16 what we're calling the benefit corporation, although I
17 will touch on B corporations and a couple of other
18 concepts as well.

19 As Susan just said, I come to you because I've
20 been representing a nonprofit organization called B Lab,
21 and I've been working for them on a pro bono project to
22 create a new form of corporation, which we're calling
23 the benefit corporation, and a bit about terminology in
24 a minute because you've heard a lot of different terms,
25 and I'll try to straighten that out in just a second.

1 B Lab has undertaken an initiative to amend
2 state corporation laws to authorize a new form of
3 corporation, which we're calling a benefit corporation.
4 Note in particular that it's a form of business
5 corporation. B Lab itself is a nonprofit organization
6 that first devoted its efforts to developing what they
7 call the B impact assessment, which is a tool for
8 measuring the performance of socially and
9 environmentally responsible businesses.

10 Any business that wants to can log on to the B
11 Lab website, take the test, and if its self evaluation
12 indicates that it has a minimum score, it can go through
13 the process of being licensed by B Lab, and then it's
14 entitled to use the B corporation logo and call itself a
15 certified B corporation.

16 The first point to note: What I'm about to talk
17 to you about, benefit corporations, is completely
18 different than certified B corporations. Certified B
19 corporation is simply a designation that any business
20 can seek to obtain from B Lab, and it's simply a
21 measurement of its environmental and social
22 responsibilities, so it's completely separate from the
23 concept of benefit corporations.

24 The project that B Lab has begun to amend state
25 laws is currently at a stage where there's activity in

1 eight states, which you can see on the chart,
2 California, Oregon, Colorado, New York, Vermont,
3 Pennsylvania, Maryland and North Carolina.

4 California, Vermont and Maryland are in larger
5 logos on the screen because legislation has actually
6 been formally introduced in those states. There's
7 activity leading towards or looking toward possible
8 introduction of legislation in the other states. We're
9 expecting that New York, Pennsylvania and maybe North
10 Carolina will actually see legislation introduced this
11 year.

12 Oregon clearly will not see anything until next
13 year. Colorado had some initial consideration of these
14 concepts. It will not see anything until at least next
15 year either, and we expect that there may be other
16 states that will be coming online as time goes by.

17 You might ask: Why that particular collection
18 of states? The answer is it's simply because there were
19 businesses already located in those states who were
20 interested in seeing this concept move forward in the
21 states, so the legislative effort that's going on in
22 these states is coming simply from businesses, actually
23 mostly certified B corporations in these states, but as
24 I said, there's legislation that is currently been
25 introduced in California, in Maryland and in Vermont.

1 So one more bit about terminology at this point.
2 If you look at California Senate Bill 1463, you will see
3 that it purports to authorize what's called a flexible
4 purpose corporation. If you read the Maryland bill,
5 you'll see that at the moment it purports to authorize a
6 B corporation, and if you read the Vermont bill, you'll
7 see that it purports to authorize a for benefit
8 corporation.

9 We don't like the term B corporation. We've
10 asked Maryland to change that because B Lab's not
11 interested in trying to enshrine in state law its own
12 concept of B corporations, so Maryland will change to
13 benefit corporations. Vermont has indicated that it
14 will be changing from the for benefit name either to
15 just benefit corporation or to something else. The
16 Vermonters love to brand things, and they may come up
17 with their own name, maybe a 3P or who knows what, but
18 we'll wait and see what comes on all of that.
19 California I think is pretty well set on being flexible
20 purpose corporations.

21 What I want to talk to you about is what's being
22 introduced in most of the states, similar to Vermont,
23 Maryland, what we're going to see in Pennsylvania, New
24 York. This is not the flexible purpose corporation in
25 California. I will tell you where California differs in

1 just a minute, but the basic concept that B Lab is
2 advocating is to create a subset of the notion of a
3 business corporation and what will define these
4 corporations, which we're hopefully going to call as a
5 general matter benefit corporations, is that by statute,
6 one of the purposes of the corporation will be to create
7 general public benefit as measured by an independent
8 third-party standard.

9 So it's a general benefit to society and
10 environment measured on some independent standard. That
11 standard is not specified. It could be the B impact
12 assessment. It could be any other standard that might
13 be developed in the future or that a B corporation would
14 want to pick.

15 The statute also says that corporations may
16 elect to create one or more specific public benefits.
17 One of the differences between the California approach
18 and the benefit corporation approach is that in
19 California, they don't have this notion of creating
20 general public benefit. What California is saying is
21 that simply you can pick one or more specific benefits
22 that you're going to seek to promote.

23 Other states are thinking about that as well.
24 That's always dangerous to predict, but I think Colorado
25 may go the way of simply focusing on specific public

1 benefits, but the notion of benefit corporations as B
2 Lab wants to create it is rather a focus on general
3 public benefit with optional specific focus on one or
4 more discrete purposes as well.

5 What's important about the statutes is they say
6 expressly that the creation of public benefit is defined
7 as being in the best interest of the corporation.
8 That's the lynchpin of the statute because when you go
9 to every one of the state corporation laws, you will
10 find that the duty of directors requires them to act in
11 the best interest of the corporation.

12 So by defining public benefit as in the best
13 interest of the corporation, it immediately has a very
14 important effect on the fiduciary duties of directors
15 and how they are to manage the affairs of the
16 corporation.

17 The last bullet on the screen can't be
18 emphasized enough. What we're talking about is a type
19 of business corporation. These are intended to be for
20 profit entities. In particular, this concept, at least
21 what I'm working on with B Lab, is not tax driven in any
22 way. The expectation is these will be C corporations or
23 S corporations, depending on the choice of the owners.

24 This is not intended to get some kind of tax
25 exemption or other public benefit. This is really an

1 attempt simply to harness the power of the business
2 community itself to take a broader view of what business
3 is all about.

4 The specific public benefits that the statute
5 says a corporation can elect to create, include, and
6 this is actually language from the statute as we're
7 seeking to have it enacted, providing low income or
8 underserved individuals or communities with beneficial
9 products or services; making insurance, for example,
10 available to people that can't obtain it otherwise;
11 promoting economic opportunity for individuals or
12 communities beyond the creation of jobs in the normal
13 course of business. We hope that most businesses are
14 growing and prospering and will be creating jobs, but if
15 the benefit corporation wants to commit particularly to
16 hiring handicaps, ex cons, people traditionally unable
17 to enter the workforce, that would be a specific public
18 benefit that could be created.

19 Preserving the environment, improving human
20 health, promoting the arts, sciences or advancement of
21 knowledge, a lot of that should sound a lot like
22 charitable purposes, but again it has nothing to do with
23 tax exemption or tax status of the entity. Increasing
24 the flow of capital to entities with a public benefit
25 purpose, and then finally, accomplishment of any other

1 particular benefit for society or the environment, a
2 catchall, if you will, although in terms of today's
3 context, maybe we think about making sure that there's a
4 appropriate news flow and investigative journalism and
5 an informed populus necessary for our democracy, so
6 possibly that last item might fit into our purposes
7 today.

8 The statutes then say that directors are
9 required to consider the interest of certain other
10 constituencies when they're making decisions as they run
11 and manage the business. The statutes, however, also
12 make clear that the weight that's to be given to these
13 various interests is not prescribed.

14 The statutes say expressly that directors must
15 consider the interests of shareholders. That's
16 traditionally been the sole focus of directors and
17 business corporations, but then they must also consider
18 the interests of the employees and the workforce, not
19 only of the corporation itself but of subsidiaries and
20 suppliers.

21 Customers, to the extent they are beneficiaries
22 of the public benefit purposes of the corporation,
23 community and societal considerations, local and global
24 environment, and importantly, the long-term and
25 short-term interests of the corporation, including the

1 possibility that those interests may be best served by
2 the continued independence of the corporation.

3 One particular concern is: What happens when a
4 business is faced with a very attractive offer to be
5 acquired by someone else that would significantly
6 benefit the shareholders but might compromise the
7 mission of the corporation? The statute's intended to
8 say that the money does not have to win, that the
9 directors can consider the possibility that it might be
10 better for the corporation to stay independent and
11 continue to try to accomplish it's long-term goals.

12 Now, this is a very important change in the law:
13 A majority of states today already say that directors
14 may consider the interest of these types of
15 constituencies, but there is no state today that says
16 that they must be. It's purely permissive, and it's
17 purely up to the directors to decide how much weight and
18 which interests are to be considered.

19 In addition to those requirements for directors,
20 the statute also will say that an officer must consider
21 that same list of interests that we just looked at when
22 two things are true. First of all, the officer has
23 discretion to make a decision, so the officer can decide
24 yes or no in a particular instance, and that decision
25 will have a material impact on the creation of public

1 benefit.

2 So there are lots of things that officers do in
3 the daily course of running a business that may not
4 directly impact public benefit. We don't want them to
5 have to think about all of the constituencies all of the
6 time, but when we have discretion and when it might make
7 a difference, the new standard will be that the officers
8 are considered I just showed you with respect to
9 directors.

10 Then the corporation is required to prepare an
11 annual report. That report is to go to the shareholders
12 of the corporation. We would like that report to be
13 publicly filed with the secretary of state in the state
14 where the corporation is incorporated. Unfortunately,
15 we found that secretaries of state cannot always
16 accommodate this additional filing and processing of
17 this additional report.

18 So some of the states are not going to require
19 that annual report, but when they don't, they do intend
20 to require that if a member of the public asks for a
21 copy of the report, then the report must be given for
22 free, without charge to any member of the public, and
23 then the statutes will also require that the report be
24 publicly available on the corporation's website if the
25 corporation has a public portion of its website.

1 Finally, some of the states that I just showed
2 you on that map will probably be providing for the
3 designation of a benefit director, who would be a
4 director of the corporation who will be independent and
5 who will be required to prepare an annual evaluation of
6 the corporation's performance, and that evaluation it's
7 intended, will go into the annual benefit report, so
8 there will be someone with the express responsibility of
9 thinking about how the corporation has done and
10 fostering public benefit, writing a little report with
11 their views, and that report has to be made available
12 not only to the shareholders but will make its way into
13 the hands of the public.

14 In addition, some states will also provide for a
15 benefit officer. That person will have the
16 responsibility for preparing the annual report, will
17 have other duties that may be assigned to the board that
18 are related to the creation of public benefit. Not
19 every state, as we've gone through this process so far,
20 has expressed an interest in either of these concepts,
21 although I think some will have both.

22 So here's a little picture of B Lab's goal in
23 all of this: What we call the evolution of a capitalist
24 businessman, and if you can't quite read the little
25 scribbles at the top, under this view of history from

1 about the 10th to the 18th century, we've the had the
2 colonial capitalist, and then in the 19th century, we
3 moved to the industrialist capitalist. The 20th Century
4 saw the shareholder capitalist. The law as it evolved
5 in the 20th Century clearly made shareholders primary.
6 That was the driving force of American capitalism.

7 But B Lab's goal is to change all of that and to
8 move our entire economy and the capitalist system to the
9 21st century and the stakeholder capitalist, where
10 business has a broader view of its mission and what it's
11 about and a focus on accomplishing more than simply the
12 profit for its owners.

13 Now, I would like to close at this point with a
14 couple of comments about what I call the irony of
15 corporate law, and the reason I want to talk about this
16 is because I think it focuses very nicely on what's the
17 really important change that's going on here.

18 If you go back to 1983, the state where I come
19 from, Pennsylvania, was the first state in the country
20 to authorize directors to consider interests other than
21 those of the shareholders. The very first what we call
22 constituency statute came into the law in Pennsylvania
23 in 1983. It was purely discretionary, completely
24 optional, and its purpose, quite honestly, was simply to
25 provide for an excuse to reject a hostile takeover.

1 Remember back in 1983 this was the start of the
2 go-go years? In fact, they may be remaking the movie
3 Wall Street, and remember how Michael Douglas made
4 Gordon Gekko the hero of everyone in business school?
5 This is the time when Michael Milken's running the junk
6 bond market, Ivan Boesky and Carl Ichan are abroad in
7 the land. Managements were fearful because their
8 traditional prerogatives were being threatened.

9 So Pennsylvania stepped in and said, When you
10 get in trouble you can point to anything you want as an
11 excuse to say no to the hostile takeover. Since 1983,
12 30 other states have followed Pennsylvania in adopting
13 these constituency statutes. Like Pennsylvania, today
14 as we sit here, every one of those constituency statutes
15 is permissive. It simply says that if the directors
16 want to, they can consider the interest of employees,
17 suppliers, communities. They're not required to, and
18 the weight that they give them is completely up to the
19 directors.

20 It's interesting when you read these statutes,
21 you find, for example, that Maryland is actually honest
22 enough to say that its constituency statute only applies
23 in the takeover context. Maryland doesn't let you
24 consider interest of employees, suppliers, communities,
25 et cetera, except in the takeover context. This is the

1 era still of shareholder primacy. We have not yet moved
2 to the stakeholder capitalist.

3 However, when you step back and think about it,
4 what we're now seeing in this move towards benefit
5 corporations in these other forms is a feeling that, in
6 fact, maybe we got it a little bit wrong, and maybe we
7 should give more weight to these other constituencies.
8 Maybe, in fact, it is appropriate to say that directors
9 should take a broader view of things, so this is where I
10 find the great irony in corporate law.

11 What began purely as self interested protection
12 of management back in the '80s has now morphed into a
13 theoretical framework and the legal basis for an outward
14 focus on the interest of others. We now have, in fact,
15 evolving a different view, all coming out of
16 management's own self interest but now turning
17 us outwards to consider the interest of other folks.

18 So thank you.

19 (Applause.)

20 MS. DESANTI: Thank you very much. Our third
21 presenter is Heerad Sabeti, who is a convening trustee
22 for the Fourth Sector Network. In 1998, he led the
23 development of the emerging Fourth Sector which
24 introduced a strategy for a new sector of organizations
25 for benefit enterprises, sounds very similar, that

1 harness entrepreneurial energy to shape a more just,
2 equitable and sustainable future.

3 Mr. Sabeti is also cofounder and CEO of
4 Transforms, FB, which was created as a laboratory for
5 implementation of the for benefit organizational model,
6 and after Heerad's presentation, then I'm going to ask
7 all of our panelists to come up, and we'll have a
8 moderated discussion along with the speakers. Heerad?

9 MR. SABETI: Thank you, Susan. So I think my
10 role here is to sort of put the overall notion of hybrid
11 legal entities and some of the models that have been
12 presented into a broader context, and I'm going to start
13 doing this by taking us to a 10,000 foot view of how
14 social and environmental and economic change happens.

15 It's no secret that the world right now is
16 facing a large number of complex, intractable and
17 interrelated problems, from climate change to poverty to
18 sanitation and water issues, malnutrition, lots of
19 communicable diseases, new ones being discovered every
20 other year, financial instability and so on, and the
21 scale of these problems seems to be escalating at a much
22 more rapid rate than the scale of solutions that we have
23 to address them. So the big question is: What can we
24 do to tip the problem curve down and the solution curve
25 up?

1 If you sort of click your heels together and
2 imagine a world, in some hopefully not so distant future
3 where that happens -- well, sorry. The slides can had
4 to get converted from a MAC to a PC, and I think we're
5 going to have some issues probably throughout this
6 presentation, so apologies for that.

7 So if you imagine -- you need to wear your 3D
8 glasses I think for this to make sense. If you imagine
9 a world where we've got fewer problems of the nature
10 we're dealing, essentially what you have to have is
11 people, most of us, thinking differently and acting
12 differently in all of the various capacities in which we
13 act every day, as investors, as consumers, as employees,
14 as voters and as taxpayers and as volunteers. We have
15 to behave in ways that incrementally create the sort of
16 broader systemic conditions that we want.

17 Well, most human activity happens through
18 organizations, broadly defined, so these are from
19 schools and churches to businesses and nonprofits and
20 foundations and governmental entities. Basically the
21 landscape of organizations, the formal organizations are
22 clustered into three sectors or three dominant types:
23 For profit, nonprofit and governmental.

24 Most human activity, one way or the other,
25 happens through those organizations so if you want

1 people to -- and those organizations are designed to
2 incentivize certain behaviors and disincentivize other
3 behaviors, so if we want people to think differently and
4 behave differently, the organization through which they
5 behave have to be structured in a way that incentivizes
6 the kinds of behaviors we want, right, in many ways
7 that's probably different than how organizations today
8 are structured.

9 So in this world we have people thinking
10 differently and acting differently, and we have
11 organizations that are structured in a way that
12 incentivizes those behaviors, but the problem is you
13 can't just organize or you can't structure organizations
14 independently. They're not -- organizations are not
15 islands.

16 Each organization exists within a broader
17 ecosystem of support, so tax policy and legal forms are
18 a piece of that, financial markets, education and
19 training, marketing and communication channels. If you
20 think about starting a business today or a nonprofit
21 organization, there's a whole host of infrastructure or
22 supported infrastructure around you.

23 You go to a lawyer or an accountant or a
24 marketing person, and they give you advice that's
25 consistent with what you're doing because it's part of

1 that robust infrastructure. You can hire employees that
2 have been trained in academic institutions that are
3 structured to train the kinds of employees that you need
4 for that model of organization.

5 So if you want organizations to be structured in
6 a way that's more consistent with the way we want people
7 to act, we need a supportive ecosystem that's tuned into
8 the structure of those organizations. So basically
9 change has to happen at these three levels: At the
10 individual level, at the organization level and the
11 ecosystem level.

12 Now, the good news is that this change has been
13 happening. If you take all organizations and categorize
14 them according to their purpose, they fall on a spectrum
15 between maximizing financial benefit to owners on one
16 hand and maximizing social benefit on the other, so for
17 profits cluster on the left side of this continuum,
18 nonprofits and governments on the right-hand side.

19 If you look at basically trends over the past
20 20, 30 years, there's been a substantial mobility of
21 organizations from the for profit end of the spectrum to
22 the right, and this is evidenced by all kinds of trends,
23 corporate, social responsibility, social marketing,
24 employee ownership, social auditing, triple bottom line,
25 corporate philanthropy, environmental management, the

1 greening of industry, ethics, on and on and on, a huge
2 trend of some for profit entities sort of broadening
3 their purpose beyond maximizing financial benefit to
4 owners.

5 The other interesting trend is if you take
6 organizations and categorize them by the way they
7 generate their income, they fall somewhere between
8 earning income through market exchange, which is where
9 for profits are, and on the other hand, basically
10 relying on contributed income, taxes, charity, grants
11 and so forth, and that's where nonprofits and government
12 basically reside.

13 So over the past several decades, there's been a
14 trend from the nonprofit and governmental sector towards
15 the market in essence, and there's lots and lots of
16 evidence, examples of this. The foundations are
17 requiring more measurable impact and accountability and
18 market discipline and efficiency and effectiveness from
19 their grantees, social investing movement, the program
20 related investments that we talked about earlier, and I
21 think we'll be talking a lot more about later, and
22 mission investing by foundations, earned income ventures
23 started by nonprofits, privatization of public services,
24 micro finance, social return on investment and so on.

25 So these are two pretty big trends, but there's

1 an even larger trend that become apparent when you plot
2 these against each other, so basically in this space, in
3 the top left corner you've got a cluster of
4 organizations that are maximizing financial benefit to
5 owners and rely on earned income. That's where for
6 profits are concentrated, and hence the private sector.

7 In the bottom right you've got organizations
8 that are relying on contributed income and pursue public
9 purposes, so that's where the nonprofit form resides,
10 and therefore the social sector, and also government and
11 the public sector are in that space. So from the last
12 two slides, these are the two vectors of change, and
13 when you look at them this way, basically a larger trend
14 becomes apparent.

15 What many people have sort of remarked on over
16 the last 20 or 30 years or so as the blurring of the
17 boundaries between the for profit and nonprofit sectors
18 is actually it looks like that the changes that are
19 happening in those sectors are different. They're along
20 sort of different axes or different vectors. What's, in
21 fact, happening is a convergence of organizations
22 towards a new organizational landscape, basically
23 defined by the top right corner of this space, which is
24 organizations that earn their income but pursue public
25 purposes.

1 While there's been a convergence of activity
2 towards this space, there's also been an emergence of
3 new forms of organizations within this space, so these
4 are hybrid organizations that don't tightly fit into the
5 traditional boundaries of the nonprofit, government or
6 private sector, lots and lots of examples of this in the
7 U.S. and around the world, social enterprises,
8 sustainable enterprises, blended value organizations,
9 nonprofit enterprises, common good corporations, faith
10 based.

11 There's a lot of faith based enterprise activity
12 in that space, non profits, chaordic organizations,
13 social economy enterprises. It's a Canadian term,
14 community development corporations, community interest
15 companies actually is what they're called in the UK, so
16 lots of calls of hybrid forms emerging in this new
17 landscape, and collectively, basically what looks like
18 is happening in the top right space is the emergence of
19 the new sector, the new Fourth Sector alongside
20 government, nonprofits and for profits.

21 So that's basically -- that's what's been
22 happening historically for some time, and now if you
23 take all of this and sort of think ahead or think about
24 the policy implications or the societal implications,
25 what do we do about it? Arguably a lot of change that's

1 happening within the sector in this direction is a good
2 thing, and a lot of this hybrid activity is a good
3 thing. You have social purposes being met through
4 market means and few people sort of argue with the
5 merits of that.

6 But how do you formalize it? So if you think
7 about basically the former Soviet Union as a
8 deconstructed and the sort of eastern central European
9 states went from communism to capitalism, essentially
10 what they did is they created two new sectors. They
11 created the infrastructure for a public sector and for a
12 social sector.

13 So it's not unprecedented for a new sector sort
14 of to be born through intentional design and effort, and
15 sort of advocates for this activity basically I think
16 believe that we need to sort of take the vector of
17 change that's been happening for some time and start
18 shaping its direction by defining this new sector.

19 And the way the sector gets defined essentially
20 is there's got to be broad consensus around the
21 archetype, the boundaries that define it, right, so what
22 we're talking is a sector of organizations and those
23 organizations have to meet certain criteria, and from
24 the models that were presented earlier, there's some
25 clearly well thought through examples of those

1 boundaries, so people are working on these issues.

2 So the idea of a for benefit corporation is
3 basically this broad notion that if we want to define
4 this new emerging Fourth Sector, whatever the
5 terminology is that people land on, there needs to be
6 broad consensus around an archetype, and so the for
7 benefit basically is a reference to that archetype, and
8 there's been a number of different efforts at trying to
9 arrive at what would define a for benefit corporation
10 and thus sort of set the boundary conditions for the for
11 benefit sector.

12 Two criteria that consistently emerge are social
13 purpose and business method, and that's sort of defined
14 by the area in this chart so that's sort of self
15 evident. Other characteristics: There's a process that
16 we went through with the Aspen Institute and a number of
17 experts from different disciplines back starting in the
18 late '90s to try to synthesize some kind of a consensus
19 and basically set of principles that would define what a
20 for benefit might look like, and the list of
21 characteristics here are what came out of that process.

22 So beyond social purpose and business method,
23 this notion of inclusive ownership and stakeholder
24 governance, fair compensation, reasonable returns, which
25 implies a limit beyond what would be considered

1 reasonable, sort of baked in commitment to social and
2 environmental responsibility, a commitment to
3 transparency that's baked in and a protection of assets
4 similar to what a nonprofit would have, sort of an asset
5 log. So that is sort of looking ahead, what would it
6 take to formalize this sector?

7 Now, depending on how you define its boundaries,
8 what's already happening in the Fourth Sector is bigger
9 than a lot of people tend to realize. Basically the
10 Fourth Sector is a class of organizations, a set of
11 organizations that reside at the intersection of three
12 formal sectors, so where the public sector intersects
13 the Fourth Sector, currently you have civic and
14 municipal enterprises, and there's four and a half of
15 those per city. I think that data is a few years old,
16 and that number is growing by 30 percent a year.

17 So you see the role of numbers here. Depending
18 on how you define the boundaries, you're talking about 5
19 to 15 percent of U.S. GDP and 10 to 20 percent of U.S.
20 jobs.

21 Where the private sector intersects the Fourth
22 Sector, you have sustainable enterprises, mission driven
23 businesses, employee owned businesses. The nonprofit or
24 the social sector intersecting the Fourth Sector, you've
25 got nonprofit enterprises and community development

1 corporations, and then there's that middle hybrid space
2 that's sort of full of all kinds of Frankenstein legal
3 entities that don't tightly fit into the other three
4 sectors. You have social enterprises, faith based
5 enterprises, lots of hybrid forms. Co-ops fit in there
6 and so on. So this just gives you a sense of the scale
7 of activity we're talking about that could be formalized
8 into a new sector.

9 Then sort of bringing it home, what are some
10 industries that might find a more amenable home in a
11 Fourth Sector where it's formalized? Journalism
12 certainly seems to be one, the marriage of social
13 purpose with an economic or business method.
14 Healthcare, there's a lot of discussion about public
15 versus private insurance, and what if there was for
16 benefit insurance? What if there was a hybrid that was
17 possible between those two extremes that have the sort
18 of best attributes of each? Mass transit, utilities,
19 education, banking and so on, so lots of applications
20 and lots more that I'm sure people will come up with.

21 So back to the first slide, while there's lots
22 of entrepreneurial activity out there, people are
23 creating these new hybrid forms and sort of pushing
24 against the boundaries of their respective sectors.

25 At the same time a support ecosystem is emerging

1 that enables all of this, so legal forms, we talked
2 about several of these today, flexible purpose
3 corporations in California, the L3C of course. SR
4 corporations was an attempt in Minnesota and Hawaii a
5 few years back.

6 In the U.K. you have community interest
7 companies; Canada, social economy enterprises. In
8 Finland -- I think Finland and Italy are actually --
9 those are enshrined in law and in the UK. The Canadian
10 experiment sort of hasn't gone as far as it could
11 because of some political obstacles they ran into, but
12 anyway, but there is an active movement to create a
13 social economy there.

14 In terms of capital markets, there's a wide,
15 wide, wide range of interesting things happening, sort
16 of new forms of capital that are seeking more than just
17 purely financial returns. Here's a bunch of examples of
18 organizations out there, Google.org and Omidyar and
19 Skull Foundations, Case Foundation.

20 I think there's a New York Times article that
21 called these guys philanthroponeurs, so a lot of the
22 dot.com philanthropists basically had a very different
23 approach to their philanthropy that took into
24 consideration for profit. It was basically sort of a
25 legal form agnostic. They looked for the social

1 outcomes, not necessarily the legal form that delivered
2 it, and that sort of has created a lot of the movement
3 in this space.

4 So social investing, the social investment
5 movement has been going on for several decades. I think
6 as of a few years ago there was \$2.3 trillion in the
7 U.S., and it was the fastest growing segment of the
8 market in the U.S.

9 Index funds, FTSE, Dow Jones and S&P have all
10 created socially motivated index funds. Community
11 development, banking and venture capital has been a
12 growing sector. I mentioned earlier mission and program
13 related investing with foundations, there's talk about
14 creating social stock exchanges. There's one in Brazil
15 and one in the U.K. that's in the making, and there's
16 folks working on creating one in the U.S.; Micro finance
17 you're all probably familiar with, and so on.

18 Oh, and in terms up ratings and certification,
19 trying to assess the impact of these organizations along
20 financial as well as environmental and social sort of
21 factors, there's been a burgeoning of new ratings and
22 certification schema. ISO has their own standard. We
23 heard about the B Corp. Dow ones is coming up with one,
24 SBAR, Inovent, Green Plus and a whole host of others.

25 This is in some way similar to how the organic

1 food movement sort of started out, and fair trade, like
2 fair trade coffees. I think that the sort of path seems
3 to be that as interests and entrepreneurship in the
4 sector grows, a whole bunch of people come into sort of
5 certify and bring validity to it, and then eventually
6 the maze of validators becomes complex, and that's where
7 I think policy needs to step in and try to clean things
8 up, as happened with the USDA organic standard.

9 So this just gives you a picture of what's
10 happening in broader ecosystem. I won't go through the
11 rest of those, and I'm going to close with a couple of
12 quotes. This is Bill Gates talking to the world
13 economic forum I think three years ago. He said: "We
14 need a creative capitalism where business and non
15 governmental organizations work together to create a
16 market system that eases the world's inequities. The
17 challenge is to design a system where market incentives,
18 including profits and recognition, drive the change."

19 And this is more recently the Pope, in his
20 encyclical letter the middle of last year, made some
21 pretty strong references to this emerging sector. He
22 said: "The traditionally valid distinction between
23 profit based companies and nonprofit organizations can
24 no longer do full justice to reality or offer practical
25 direction for the future. In recent decades, a broad

1 intermediate area has emerged between the two types of
2 enterprise. It is to be hoped that these new kinds of
3 enterprise will succeed in finding a suitable, juridical
4 and physical structure in every country."

5 So don't take our word for it. Thank you very
6 much.

7 (Applause.)

8 MS. DESANTI: Thank you very much. Now, I am
9 going to ask all the speakers and panelists to please
10 come up.

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1 PANEL 2: Corporate & Tax Approaches to Restructure News
2 Organizations.

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22 MS. DESANTI: I would like to now introduce our
23 additional panelists on this topic. Carter Bishop is a
24 professor of law at Suffolk University Law School and a
25 visiting faculty member at the Columbus School of Law,

1 Catholic University of America.

2 Allen Bromberger is a partner at Perlman and
3 Perlman, LLP. His practice focuses on hybrid legal
4 structures and arrangements that permit the pursuit of
5 economic and social goals simultaneously.

6 Steven G. Frost is a partner at Chapman and
7 Cutler LLP. Previously he served as a senior counsel in
8 the Office of Tax Policy At the Department of the
9 Treasury in Washington, D.C., where he was responsible
10 for the development of administrative guidance and
11 legislative initiatives for pass-through entities.

12 Elizabeth Grant is the attorney in charge of the
13 charitable activities section of the Oregon Department
14 of Justice, which she joined in 2003. We're very glad
15 to have you back here because prior to joining that
16 organization, she worked for approximately 12 years as
17 an attorney in the FTC's Division of Marketing Practices
18 in the Bureau of Consumer Protection.

19 Robert Keatinge is of counsel at Holland and
20 Hart, LLP. He practices in the areas of business
21 organizations, taxation and professional responsibility.

22 Elizabeth Carrott Minnigh is an attorney in the
23 tax section at Buchanan, Ingersoll and Rooney PC, where
24 she serves as vice chair of the firm's nonprofit
25 organizations group. Ms. Minnigh focuses her practice

1 on nonprofit organizations, trusts and estates and
2 family businesses.

3 Finally Lee T. Phaup, I hope I'm saying that
4 correctly, is a senior tax law specialist, TE/GE,
5 rulings and agreements, Internal Revenue Service.

6 Now, I need to make a particular comment about
7 Lee's status, which is that she is in the position as a
8 government representative that she's on a very short
9 leash, and having been in that position myself many
10 times, there will be questions that it will seem to you
11 it might be logical to ask the IRS representative, but
12 we're just not going to do that because she's not
13 authorized to give us all of the answers that we all
14 could want, but it's wonderful that she is here because
15 she can help us clarify things, and it also gives you a
16 chance to bring back some feedback to your agency about
17 the intense interest in getting further guidance in some
18 of these areas.

19 So I am going to start as simply as I possibly
20 can because this is not that easy to understand for
21 those of us who haven't lived our lives in this area,
22 and if you see me going off and you think I'm getting
23 things confused, please interrupt me. Turn your table
24 tent up when you want to speak, and in general when you
25 want to speak, turn your table tent up.

1 I wanted to start with the notion of how you get
2 tax exemption and clarify a couple of things, to the
3 extent they can be clarified. One is, to be tax exempt
4 as a 501(c)(3), an organization must be organized and
5 operated exclusively for exempt purposes, so when I go
6 and looked at the exempt purposes, and I went to the IRS
7 website for this, the exempt purposes are charitable,
8 religious, educational, scientific, literally, testing
9 for public safety, fostering national or international
10 amateur sports competition and preventing cruelty to
11 children or animals, and the term charitable is used in
12 its generally accepted legal sense, and it includes some
13 other things.

14 I wanted to ask you, Steve Frost: Is it now
15 clear that newspapers have a charitable purpose?

16 MR. FOSTER: Can I turn it over to Lee? Well,
17 it's interesting if I can answer you.

18 MS. DESANTI: You know what, I'm going to ask
19 everybody to please speak into your mikes because
20 apparently some people were having trouble hearing
21 before.

22 MR. FOSTER: If I can step back for a moment.
23 You said two things, Susan, when I came in that really
24 started me thinking this afternoon. One of the things
25 you said is you wanted to focus on whether or not

1 newspapers could operate in a tax exempt fashion, which
2 I think is driving this discussion.

3 The second thing you said when I walked in and
4 we were talking with Lee for a moment, you said, This is
5 very difficult stuff, and I would like to kind of frame
6 your question, if I can, with what I really think the
7 issue is because there's a number of red herrings out
8 there, and if you look at it in a certain way, it might
9 be helpful.

10 If you look at the case law and the rulings
11 dealing with publishers and newspapers, and there have
12 been cases, there have been IRS rulings, published in
13 private rulings, it isn't exactly clear where the line
14 is. Publishers can operate essentially in what I would
15 call a non commercial manner, and they can be tax
16 exempt. Typically they're not going to be profitable.
17 So if you look at something, a publisher or a newspaper
18 that's operating in a profitable manner or in a
19 commercial fashion, it's not likely to be an exempt
20 organization.

21 So the question I think is that I would -- there
22 isn't a clear answer to what you're asking, but I think
23 the question really is: What are the things that you're
24 looking to do that you would want the tax law, as a
25 policy matter, to achieve because once you identify

1 specifically, what are those things as a policy matter
2 that you want to permit, whether it's -- examples might
3 include enabling newspapers to raise capital by machines
4 that print newspaper so that they could get capital
5 loans or something like that.

6 Once you have those things that you want to
7 accomplish, then I think it's easier to have the
8 discussions with Treasury and the policy people to see
9 if you can identify and define those things so that they
10 can be done because right now I don't think it's clear
11 to be done.

12 The other point that I was going to make in
13 terms of trying to keep it as simple as possible, there
14 were several really good presentations this afternoon on
15 benefit corps and L3Cs and the Fourth Sector and what's
16 going on, but I think in a sense for this narrow
17 question, it's almost a red herring because basically if
18 you step back, either the entity itself, the newspaper
19 is exempt or the newspaper is not exempt, and what
20 you're talking about doing is funding it through the PRI
21 that would be made by a foundation.

22 In either case, what you're focusing on is that
23 the proceeds are used for an exempt purpose that you
24 were just describing, and if the newspaper itself is not
25 exempt, if it's a L3C, if it's a partnership, if it's a

1 corp, it really doesn't matter. There are a number of
2 other requirements in the tax law, so, for example, if
3 you're making that PRI to a non exempt entity, you have
4 to maintain expenditure responsibility.

5 You're going to, as a foundation, have to know
6 how that money is being spent. You have to be assured
7 that it's being spent in the exempt function, and
8 whether it's going to a L3C or whether it's going to a
9 partnership isn't going to matter.

10 One last point on that. For example, I looked
11 in the Illinois law and if you had an L3C in Illinois,
12 it could change its purpose, no longer be an L3C, and
13 the only consequence is that it changes its articles, so
14 if I'm that foundation and I'm making the loan, I need
15 to be sure that the proceeds are being used for that
16 exempt purpose that you've essentially identified.

17 So I hope I've helped.

18 MS. DESANTI: Well, let me go back. Let me go
19 back and unpack some of what you said. Let's take as an
20 example, suppose you are a new online news site. You're
21 working out of your house. You and your wife are
22 creating the news, and you have advertising revenue but
23 heaven knows you're not profitable.

24 You have operating revenue, but you're not
25 really making profits, and you also accept donations.

1 Is there guidance from the IRS on how they would look at
2 the potential for a tax exempt status for that online
3 news site?

4 MS. PHAUP: We do have guidance for exempt
5 organizations, and it's a little different. You're
6 talking about the initial exemption application, and we
7 do have instructions and publications out there that
8 give you guidance as to all the tests that you must meet
9 in order to be an exempt organization with the Internal
10 Revenue Service.

11 MS. DESANTI: I think in general we're all
12 finding this is a very quiet group, and you're going to
13 need to move your mikes closer.

14 MS. PHAUP: I just said we do have publications,
15 and we do have guidance out there in addition to the
16 instructions, to the form where the exempt organization
17 applies to be exempt with the Internal Revenue Service.
18 That does give guidance as to the tests that you must
19 comply with, both the organizational test and the
20 operational test, so that does give guidance to
21 organizations.

22 MS. DESANTI: Okay. But I'm talking more
23 broadly. I take it from what Steve -- Steve, from what
24 you said, I don't know if they're letter rulings or what
25 that have talked about publishers and the extent to

1 which their activities are seen as fulfilling a
2 charitable purpose, but I took it from what you said
3 that that's unclear. Is that correct?

4 MR. FOSTER: There are some cases, there are
5 some rulings, and they come up when there's a dispute
6 between the government and the taxpayer as to the
7 status. I don't believe that all determination letters
8 are published, so you don't know specifically what is
9 qualified.

10 MS. PHAUP: We do publish what we call private
11 letter rulings, where somebody comes in and asks like,
12 for instance, whether a program related investment is
13 okay, what the service under Chapter 42 is, but those
14 private letter rulings are not precedential value, so
15 you cannot rely on them.

16 I mean, some people use them as guidance, but
17 you cannot rely on them. We do have revenue rulings
18 that would assist as well, but private letter rulings,
19 though we do issue, are to a specific taxpayer and for a
20 specific set of facts, but they are published under
21 6110. They are available to the public.

22 MS. DESANTI: Thank you. So as far as the test
23 of tax exempt status, for the first criteria, it's
24 unclear whether news organizations would necessarily be
25 considered to be operated for charitable purposes.

1 Next there's a requirement that none of the
2 earnings of the exempt organization inure to any private
3 shareholder or individual, and then there's the
4 requirement that the organization may not attempt to
5 influence legislation as a substantial part of its
6 activities, and it may not participate in any campaign
7 activity for or against political candidates.

8 Let me ask you: Is there any guidance, even if
9 it's in the form of letter rulings, which do not have
10 precedential value? Is there any guidance on news
11 organizations and just how far they can go in terms of,
12 would reporting on legislation be considered attempt to
13 influence legislation? If you do an analysis of the
14 legislation, would that be considered an attempt to
15 influence the legislation, the endorsement of candidates
16 that is typical for news organizations?

17 Is there any type of guidance that exists
18 right now to which someone who wanted to set up a tax
19 exempt news organization could look to see how far it
20 can go and how narrowly it has to constrain its
21 activities with respect to legislation and political
22 campaigns? Steve?

23 MR. FROST: The two rulings that I'm aware of,
24 which --

25 MS. DESANTI: Could you pull the microphone up?

1 MR. FOSTER: There are two private letter
2 rulings that I'm aware of. One is 95-51-005, and the
3 other is 2000-34-037, and they basically addressed PRIs
4 that were made to media organizations in other areas of
5 the world to promote information and democracy in those
6 areas.

7 There's not a lot of detail in the rulings to
8 help in understanding the limits for how that would
9 apply. I'm not sure if other panelists --

10 MR. LANG: If I could make a comment here. I
11 think the new puzzle from the ABA tax section,
12 definitely they have obviously looked at a lot of what
13 you have done, and item 16 essentially says it's time
14 for you to include investment in newspapers into your
15 examples as an acceptable PRI, and their analysis
16 comment here is: "This proposed example highlights the
17 need to support for profit newspapers struggling to
18 exist in the age up digital media."

19 It highlights the need for charitable dollars to
20 support a new foreign affairs coverage, for example, and
21 educational resource for the general public.

22 Also I have here a letter from the Knight
23 Commission, and they're raising First Amendment issues,
24 and they're saying, in the end: "In a nation with a
25 First Amendment, we should not be chilling speech and

1 new forms of community media."

2 And one more thing, if I can just defer to
3 Elizabeth for three seconds, she can tell you that there
4 are proposals in the federal law that we're proposing
5 that would address directly the issues, if I could
6 bring -- can we bring that up?

7 MS. DESANTI: Just wait a minute, Bob. We have
8 a lot to get through.

9 MR. LANG: It does cover it.

10 MS. DESANTI: Yes, I know, but you are also
11 talking about PRIs, and I'm just trying to get a very
12 narrow issue of tax exempt status.

13 MR. LANG; no, no, it covers both categories. It
14 covers all nonprofit and PRIs.

15 MS. DESANTI: But we are not going there yet.
16 I'm just trying to get an answer on the tax exempt
17 status and the extent to which there's guidance, and
18 thank you, Steve, for those letters.

19 Yes, Allen?

20 MR. BROMBERGER: I just wanted to speak partly
21 from the point of view of a practitioner, and I advise
22 clients of this stuff all the time, so let me just see
23 if I can actually give you an answer to your questions.

24 Number 1 is certainly you could have a
25 newspaper, as we traditionally think of them. There are

1 lots of organizations, 501(c)(3) organizations who
2 create what we would call journalistic content.

3 Some of them do distribution as well. Some of
4 them do distribution, but they don't originate the
5 content, so there's some distinctions there but, for
6 example, a couple of things. Number 1 is 501(c)(3)
7 organizations have to pay a tax on revenues that are not
8 substantially related to their exempt purpose. This is
9 called the unrelated business income tax.

10 There's an IRS ruling that says advertising in
11 periodicals is per se unrelated business income, so even
12 though the newspaper might be tax exempt, the revenue
13 that it gets from advertising income will be subject to
14 tax under UBI, and it doesn't matter under the existing
15 law whether the content of that advertising is related
16 or not related to what the charity actually does. So
17 that's a very important thing.

18 The other is that there are a line of cases that
19 say that publishing activities, publishing of books,
20 publishing of periodicals, in and of themselves is not a
21 charitable activity, so the creation of the news and the
22 content may be, but if you are to set up an organization
23 whose sole purpose it was to publish and in this E-era,
24 I'm not -- we don't really know what publish may mean,
25 but there's a whole world of nonprofits that are

1 blogging and they're on Facebook and are disseminating
2 news and information through all kinds of alternative
3 ways on the Internet.

4 None of them that I know of is having their
5 taxes exempt status challenged, so I think the real
6 question is not so much is it 501(c)(3) or not
7 501(c)(3). The real question is: Can you live within
8 that 501(c)(3) designation and still be able to do the
9 things that you want to do to be financially viable or
10 to carry out your mission.

11 MS. DESANTI: That's very helpful. Thank you.
12 Anybody else before we move on to program related
13 investments? Yes, Carter?

14 MR. BISHOP: I would just add, I agree with what
15 Allen has stated. I think I actually am a little bit
16 more optimistic about 501(c)(3) status for newspapers
17 than perhaps some others may be, but that doesn't mean
18 that I would disagree with Allen's comment that it's
19 very difficult for a traditionally operated newspaper to
20 live with or desire those restrictions.

21 The only reason for a newspaper to become a
22 501(c)(3) is to access private capital, which is a form
23 of public capital once it's filtered through the tax
24 system in the form of a tax deduction. Otherwise there
25 would be nobody that would want to live with the

1 restrictions on exempt organization capital that exists
2 inside an exempt organization.

3 So that's why the other sector organizations are
4 more attractive alternatives, where the money is
5 accessed and filtered through other exempt organizations
6 as opposed to the principal operating entity, if that
7 makes sense.

8 MR. BROMBERGER: Just one last comment, and that
9 is the point that you made about political endorsements.
10 It's an absolute no, no for 501(c)(3). It's not even a
11 gray area.

12 MS. DESANTI: Anything else? Okay. Thank you
13 very much. All right. Lee, could you just give us the
14 nuts and bolts of what's required for program related
15 investments, and so we'll have that as start off for our
16 foundation for the discussion to come?

17 MS. PHAUP: Just to give you a little back up of
18 it. Private foundations, once they become exempt, are
19 subject to what we call Chapter 42 of the code, and all
20 that encompasses is certain code sections, 49-40 through
21 49-48. One of those code sections is 49-44,
22 jeopardizing investments. A foundation is prohibited
23 from investing its assets into a jeopardizing
24 investment.

25 You want the private foundation to use good

1 judgment, business judgment and prudence when it invests
2 those assets because you want to retain the assets to
3 benefit the charitable constituents. An exception to
4 jeopardizing investment is what we call the program
5 related investments, so it's an exemption under the
6 Chapter 42 rules.

7 In order to be a program related investment, you
8 need three requirements, and that's set forth in our
9 regs at 53-49-44-3. The first and primary requirement
10 is that it has to substantially further the exempt
11 purposes of the foundation, so they have to be that when
12 you go back, you look at the articles of the
13 incorporation or the organizing documents of your
14 foundation, and where they were first declared exempt
15 from the Internal Revenue Service, you need to look and
16 make sure that those purposes are furthered with this
17 investment.

18 The second requirement is that you can't -- it's
19 this investment is not for the primary purpose of
20 production of income or the appreciation of property.
21 That doesn't mean per se that if the investment makes
22 money, it's not a program related investment, but the
23 purpose has to be focused on achieving the charitable
24 purposes of the foundation. The third is the investment
25 cannot be used for political or legislative activities.

1 Another thing that I want to focus on that
2 sometimes gets lost is that Chapter 42 is a very complex
3 section of the code, and when you're looking at it for
4 program related investments, other sections of the code
5 may be implicated because they're all commingled. Like
6 section 49-41 of the code involves self dealing, and
7 private foundations are subject to that.

8 So you can't just look at it in a vacuum. You
9 need to look at all the other sections of the code, and
10 if you violate jeopardizing investments, there's a two
11 tiered tax that's on the foundation manager as well as
12 on the private foundation.

13 MS. DESANTI: And my understanding is it's a
14 very steep tax. Is that correct?

15 MS. PHAUP: Yes, it can be steep. It's 5
16 percent, and it's on the foundation manager itself in
17 addition to the private foundation so you want to avoid
18 it.

19 MS. DESANTI: Yeah, okay. Okay. What I'm
20 hearing then, as part of a foundation figuring out
21 whether it could make an investment that would be
22 considered a PRI, it would have to compare that
23 investment to the exempt purposes of the foundation
24 itself, so it's sort of an individualized test; is that
25 correct?

1 MS. PHAUP: Yes. It's very fact specific, very
2 heavily intensive when you look at -- when we get
3 private letter rulings in that involve program related
4 investments. Yes, we have to make sure one that, the
5 purposes are charitable and that it conforms to the
6 purposes of the foundation for which it was granted
7 exemption from the Internal Revenue Service.

8 MS. DESANTI: And one of the things that we've
9 heard in talking with people who are thinking about
10 these kinds of things is that foundations are sometimes
11 leery of doing PRIs, and part of it is the cost of
12 getting a letter ruling, and I am wondering: To what
13 extent has it been your experience that foundations are
14 comfortable saying, Oh, yes, I think that I'm -- this
15 investment that I am going to make is going to be a PRI,
16 and I'm fine with the IRS?

17 To what extent do you find that people want the
18 comfort of actually having the IRS specifically look at
19 the PRI to make sure that the IRS agrees that it's a
20 PRI?

21 MS. PHAUP: I think I can answer part of that,
22 and I may have to defer to somebody else on the other
23 part of that. Just to clarify, a private foundation
24 does not have to come to the Internal Revenue Service in
25 order to make or enter into a program related

1 investment. It's good that they do, just to make sure
2 that it meets our requirements, but they are not
3 required to get a private letter ruling.

4 Regarding what the private practitioners think,
5 I have to defer to somebody else.

6 MR. FOSTER: Susan, I had lunch yesterday with
7 an attorney with a foundation in Chicago, and their
8 foundation has done over a hundred PRIs, and they've
9 gone into the service for two or three rulings. So the
10 times that they we want in for the rulings was where
11 there was something very unique or unusual about the
12 situation they were concerned about, but normally they
13 don't require them.

14 When I was preparing for this, I talked to one
15 of my partners, who proceeded to give me an opinion that
16 he had given recently in a PRI in the last month or so,
17 so I think it's fair to say -- and I did ask the
18 foundation person I met with what his experience was,
19 and generally he told me that many people do these deals
20 without the ruling as a normal course.

21 MS. DESANTI: Other comments on this? Robert,
22 thank you?

23 MR. KEATINGE: I can confirm what Steve is
24 saying. We've talked to a very large private foundation
25 that we work with fairly regularly, and they make

1 internal determinations on some PRIs and get opinions of
2 counsel with regard to others and have not felt it
3 necessary to go in for private letter rulings, although
4 they do also confirm that these are very delicate
5 foundation objective analyses that they undergo in the
6 course of making the determination whether they're
7 comfortable that they are PRIs.

8 MR. LANG: One conversation. Before we started
9 on the L3C path were that the more comfortable a
10 foundation got with doing this, such as the one you're
11 talking about, they got very, very comfortable because
12 they developed a group of people within the foundation
13 that understood the rules and said, Here's how you
14 follow the rule book.

15 The real problem comes with probably the other
16 75,000 foundations that are relatively small that don't
17 have the type of internal expertise, and very often they
18 go to a counsel once, and if they don't have a regular
19 counsel, it's going to be an expensive proposition to
20 get a true opinion of counsel, so it's all over the map.

21 MS. DESANTI: Yes, Carter?

22 MR. BISHOP: Susan, I might also say that I
23 think it probably varies depending upon whether you
24 would consider this a traditional versus a non
25 traditional PRI, so I mean, the more you move away from

1 and into the sort of zones that we're talking about
2 today, which is non traditional program related
3 investment, the less likely it is that somebody is going
4 to make an internal determination, the less
5 likely they're going -- a foundation manager, the less
6 likely they're going to rely on consul and more likely
7 they're going to want some other kind of broader view
8 from the service, so I think that's the road block.

9 MS. DESANTI: Elizabeth, could you tell us the
10 state perspective on these things?

11 MS. GRANT: I would be happy to.

12 MS. DESANTI: Can you get the mike?

13 MS. GRANT: I think that there's been a lot of
14 discussion about these hybrid forms, but not a lot of
15 discussion of the state role. To some extent we track
16 what IRS requirements are, but I think in some sense
17 it's simpler than that. I think that if an organization
18 or a newspaper or whatever type of organization might be
19 represents that its purpose is to be charitable or
20 socially beneficial, if you say you're a charity under
21 state law, then you may be subject to state regulation
22 as a charity under state law.

23 That raises a whole -- so it's fairly simple
24 that way, and there's a lot of registration and
25 reporting requirements that apply to organizations that

1 represent their intent to benefit charitable purposes,
2 and so of course one of our concerns with these hybrid
3 forms is how those registration and reporting
4 requirements apply.

5 And I think if we look broadly, the purposes of
6 those requirements is not just to collect paperwork, but
7 traditionally it's the job of state attorneys general to
8 make sure that charitable organizations do not divert
9 charitable assets or that they're not diverted to
10 private interests and to preserve and maintain those
11 charitable assets for the public purposes that they're
12 intended to fulfill.

13 So those reporting requirements are related to
14 that objective in terms of preventing the diversion of
15 charitable assets and to ensuring that they're used
16 for public purposes.

17 I'm going to sort of harken back to my days here
18 at the Federal Trade Commission because I think a lot of
19 some of what's being raised here today is actually
20 almost akin to advertising law because you're going to
21 have these entities that are out there representing that
22 they're unique and that they're more socially beneficial
23 and better than other forms of enterprises. I think
24 that the public is entitled to know the basis for those
25 claims and to have the information available that they

1 would be able to make an objective assessment about,
2 which is the same thing that our office would be doing.

3 I think fundamentally we're going to be looking
4 at whether an organization is advancing charitable
5 purposes, and when I think about how I'm going to be
6 doing my job, it gets complicated in this hybrid realm
7 because traditionally, one thing I know about nonprofit
8 corporations, there's a whole body of law established,
9 and there aren't equity interests.

10 So I can look, and if I see that the nonprofit
11 is distributing profits to private individuals, I can
12 say that's a problem or that's not consistent with the
13 law, but with these hybrid forms, I hear in some sense
14 well some amount of distribution is appropriate, but I'm
15 not really sure what amount is appropriate, and when can
16 you say that they're distributing too much and not
17 really furthering the charitable objectives of the
18 organization anymore?

19 I think in the context of newspapers, for
20 example, I think this raises interesting issues about,
21 let's say for example advertising. Advertising is
22 traditionally not a charitable purpose, so if I'm
23 looking at something that a newspaper or a publication
24 that claims that it's charitable, will I be looking at
25 how much advertising is in that publication, and how

1 does that compare to the more educational value of the
2 publication?

3 So, for example, and I think that the devil is
4 in the details, and when we're talking basically about
5 how these organizations are organized, but the second
6 and probably harder test is how they're going to operate
7 in real life, and, for example, can you have an
8 operating agreement where an advertiser is an investor
9 and says, I'm going to invest in your paper, but I want
10 to make sure that I get front page and back page
11 coverage. Is that advancing charitable purposes? Would
12 that be something that our office would say, no, that's
13 not consistent with the charitable purposes of the
14 organization?

15 In some sense, with these hybrid forms you're
16 swapping out duties. Directors have duties to the
17 shareholders in a traditional corporate form, but now
18 they have duties to the public to use the newspapers to
19 fulfill those public purposes, and so our role is to
20 make sure that the directors or the managers of these
21 new entities are, in fact, filling those fiduciary
22 duties, so to some extent it's simpler, but also more
23 complex and subtler than some of the tax issues.

24 MR. LANG: Actually you have conflicts within
25 your own laws on some of this because, for example, IRS

1 recognizes economic development in certain areas as part
2 of acceptable PRIs, so if you we want into Detroit,
3 which doesn't have the newspaper coverage it used to
4 have, you can actually make a very good case that
5 business is being hurt by lack of newspapers in which to
6 advertise and promote their business.

7 So I'm not going to say I'm rooting for more
8 front page advertising, but you have to start looking at
9 the regulations, and again what you said on the chance
10 to regulate them, I'm going to tell you that every state
11 we've ever written the law for, one of the things we had
12 proposed is that they have the right to basically take
13 away the L3C designation if, in fact, they fail to
14 comply with that.

15 And you know what? In most states the secretary
16 of state has opposed that, and they said we don't
17 want -- we said, Well, let the Attorney General do it,
18 we don't want to have anything to do with it, we just
19 want to collect the money.

20 MS. GRANT: That's understandable.

21 MS. DESANTI: Gus, do you have a question?

22 MR. CHIARELLO: Actually maybe it is kind of
23 resolved in some of the discussion here, but, Elizabeth,
24 in considering the hybrid organizations and their
25 obligations for the social purposes, at the state level

1 and policymakers, have you considered the level of
2 transparency that would need to be required, kind of
3 across the board for the public and for enforcers and
4 policymakers and whatnot?

5 MS. GRANT: Well, I think that State Attorneys
6 General's office are familiar with the transparency that
7 is required of nonprofit corporations. When we were
8 talking about making information publicly available to
9 journalists, I think if you look at the nonprofit realm,
10 charities file financial reports that are available,
11 easily available on the Internet at no cost, and I work
12 frequently with journalists, and we work together to
13 sort of monitor the nonprofit sector.

14 I think what remains unanswered is to what
15 extent with these hybrid forms that same information
16 will be available to the public, and I think that's
17 something that needs to be incorporated into any legal
18 developments in terms of making sure that that
19 information is available.

20 MS. DESANTI: Elizabeth?

21 MS. MINNIGH: That is one thing that we are
22 working for, and that is one of the reasons why we would
23 like to get some type of federal legislation passed is a
24 requirement that anyone who represents themselves as
25 being an L3C, an entity that is going to be receiving

1 these PRIs, make the same type of disclosures that a
2 nonprofit organization currently makes so that that
3 information is available to the public, and also so that
4 it's available to the IRS and to the Attorney Generals
5 so that they can start tracking these things and find
6 out the people who aren't using it correctly.

7 B corporations obviously are searching for that
8 same level of transparency, so I think that's something
9 that everybody wants. I think the big problem is going
10 to be finding the funding at the federal and state level
11 for these to be reviewed.

12 MS. DESANTI: William?

13 MR. CLARK: If I can comment on the last point,
14 one of the things we've wrestled with is the proper role
15 of government in all of this, and every state that I've
16 gone to where I've talked to politicians about this new
17 concept of a benefit corporation, the first reaction we
18 get is: Well, we need to figure out which agency of
19 government is going to monitor their performance, and
20 our immediate reaction is: No, no, you don't
21 understand, that's the last thing that we're trying to
22 do.

23 Yes, it makes sense that if you're getting some
24 public benefit, the government has to police that, but
25 what we are trying to create is a form where it's a

1 contract among the people who are involved. There are
2 no tax benefits, so the government doesn't need to
3 police. You report publicly, and the whole notion is
4 that the light that's cast, the sunshine that has its
5 effect to sanitize and has prophylactic effect, will be
6 sufficient.

7 It very much disturbs me to think that we're
8 heading down a path here where I see the government
9 becoming more involved, and you mentioned First
10 Amendment, and at some point I hope that we get around
11 to that because I'm sitting here thinking to myself,
12 Well, if one of the things we're worried about is the
13 disappearance of local newspapers, what happens if we
14 want to foster local newspapers, and to pick an extreme
15 example but I can see it happening, the Ku Klux Klan in
16 a community starts to publish a newspaper.

17 We don't like the Ku Klux Klan. We would be
18 worried about what they said, but if they started out
19 and for the first year that they're in operation there
20 is no discernable bias, there is no racial -- the
21 offensive content to the newspaper, and they are the
22 only local newspaper in the area, why shouldn't they get
23 the same subsidy the government is going to provide to
24 another local newspaper if we go down that road?

25 Then when they get it, who then is going to read

1 their newspaper everyday to figure out when they finally
2 decide they're safe enough that they can start to slant
3 their news? I find the whole thing personally rather
4 offensive, and I don't know whether you want to get into
5 this, and I apologize for having missed the rest of the
6 workshop, but it seems to me that the whole premise of
7 this workshop is that we have conceded defeat, that
8 we've conceded the notion that newspapers can't make it
9 on a profitable basis, to which I say, Well, is that
10 such a bad thing?

11 We heard a presentation about the Internet and
12 about E publishing. Maybe it's time to recognize that
13 buggy whip businesses go out of business. Maybe it's
14 time to recognize that what we ought to do is
15 reconfigure our broadcast laws so that media
16 conglomerates aren't restricted in what they can do so
17 that news comes from a different source.

18 I think I've taken this completely off, and I'll
19 be quiet, but I find the whole thing very troubling, and
20 it's raised by this notion that the IRS is going to
21 police journalism, and if we're going to give newspapers
22 a tax break, we have to, or our whole system will
23 breakdown.

24 I am personally offended as a taxpayer that
25 people are going to get a tax break if they're not

1 entitled to it, so we have to police it, but if we
2 police it, we destroy the basis of our free society.

3 Enough said. I'll be quiet.

4 MS. DESANTI: You know, you've challenged me,
5 William, to try to unpack that. Let me start, you
6 should come tomorrow afternoon between 1:30 and 2:30
7 when we're going to have three presentations on the
8 long, long history of government tax subsidies for the
9 press. This is not a new thing at all. There are still
10 tax subsidies having to do with print and other things,
11 and there's a new report from the Annenberg Center for
12 Communication Studies at the University of Southern
13 California that goes through this in detail, has many
14 papers associated with it, and tomorrow we're going to
15 hear about the history of postal rate subsidies from the
16 current chairman of the Postal Regulatory Commission.
17 So there's a long history of that.

18 Having said that --

19 MR. CLARK: That's a little different than a
20 basic tax exemption from income tax. That's night and
21 day in my world.

22 MS. DESANTI: Well, you know, in my world money
23 is money, so....

24 MR. LANG: Look, Microsoft just bought our
25 screen.

1 MS. DESANTI: So at any rate, there are a lot of
2 considerations that should be taken into account, in any
3 policy discussion, policy proposal, so certainly this
4 isn't the only one that's on the table, but it is an
5 important one that we need to understand.

6 I think one thing that's important to keep in
7 mind when you're talking about your benefit corporations
8 as opposed to these hybrid corporations, and correct me
9 if I'm wrong, Elizabeth, but my sense is that if it's a
10 for profit corporation, as you say, William, that can be
11 policed by the contracts among the members because
12 they're not claiming tax exempt status so I don't --

13 MR. CLARK: I don't think they would be
14 interested at all in a for profit benefit corporation.

15 MR. LANG: Actually if I can say something. I
16 think that depending on the state, that's not true. One
17 of the battles we went through in Illinois was that
18 clause in there for the charitable act to take effect
19 because we felt the way you do. Basically the premise
20 behind the L3C is it is a for profit. It is subsidized
21 capital in a certain sense, but after that it operates
22 as a for profit.

23 So we don't belong under the Charitable Trust
24 Act, but the Charitable Trust Act in Illinois is so
25 broad that any for profit corporation that operates in

1 Illinois, technically if it claims to do anything
2 socially beneficial or charitable, falls under that act,
3 and they have never gotten around to enforcing it
4 probably for lack of money.

5 MR. CLARK: That act is wrong, and it needs to
6 be amended.

7 MS. DESANTI: Elizabeth, we'll go to our state
8 representative now. Elizabeth?

9 MS. GRANT: I would like to address those
10 issues. I think for one thing, if you're not getting
11 government subsidies, and I think that PRIs is a form of
12 government subsidy, the concerns are perhaps less, but
13 on the other hand, I guess why is it that one wants the
14 certification, and I think it relates to wanting to hold
15 one's self out to the public as being socially
16 beneficial.

17 We've seen, in the advertising context, that
18 charitable appeals are very appealing, that consumers
19 react. They will buy things because of the charitable
20 appeal, so I think that there are genuine issues raised
21 by how does one know that one's fulfilling the standards
22 and what are those standards that are related to that
23 certification?

24 So the oversight might not be as extensive, but
25 I still think that there is a need for government

1 oversight even for profits that do not receive tax
2 subsidies.

3 MS. DESANTI: Okay. You don't think that that
4 would be cured by transparency?

5 MR. CLARK: That's the opposite.

6 MS. GRANT: It might, but what if they're not
7 transparent? What if they're not --

8 MS. DESANTI: What if the transparency
9 requirements were written into the law?

10 MS. GRANT: Well, what if they don't follow --
11 the transparency requirements are there, but say, for
12 example, in the SEC, you can have a disclosure document
13 that isn't accurate, so what if you have a disclosure
14 document that doesn't actually say what's going on in
15 the company, who's going to watch the watchman, so to
16 speak?

17 MS. DESANTI: Elizabeth? Another Elizabeth.

18 MS. MINNIGH: Yes, that's the same problem with
19 nonprofits though. Nonprofits have to disclose
20 information on their information return, but if they lie
21 or withhold or misconstrue, that information isn't
22 publicly available, so it's the same concern that is
23 with any entity, is that the disclosure has to be
24 accurate. I don't see that as a special concern for
25 hybrids.

1 MS. GRANT: But I'm authorized to investigate
2 and take enforcement actions against charities that
3 engage in that kind of behavior. It's not as clear what
4 laws are out there to protect the public from hybrids
5 that engage in similar activities.

6 MS. DESANTI: Wait a minute. I was just asking
7 about for profit corporations. I wasn't asking about
8 hybrids because hybrids it seems to me raise this
9 difficult question of: Is there money that is somehow
10 flowing from the foundation into the pockets of the
11 private entity?

12 And so I took that -- but you're saying that
13 just for profit corporations that have a social purpose,
14 it's your position that that social -- those
15 corporations should have oversight so that the
16 government confirms that, in fact, it's operating
17 pursuant to the social purpose?

18 MS. GRANT: I think I would go back to, I think
19 it's analogous to advertising law, that they're making
20 representations and that there needs to be some
21 governmental entity that can investigate the accuracy of
22 those representations.

23 MS. DESANTI: William, what's your view on this?

24 MR. CLARK: Exactly to the contrary.
25 Transparency we believe is also critical, okay, and

1 there's no question about that, and our experiment may
2 prove to be unsuccessful, but the theory is that making
3 the information available, particularly for example in a
4 for profit business where they're looking for an
5 advantage in the marketplace, if a socially responsible
6 business is competing with one that's not and trying to
7 attract customers based on its social responsibility,
8 you would think that its competitor would have every
9 incentive in the world to read its report, to
10 investigate its transparency, and if it's not behaving
11 properly, call it on its lack of behavior.

12 So I personally think we're making a big mistake
13 if we want to broaden this to get the government
14 involved. I think you will meet substantial resistance
15 from the business community that you wouldn't otherwise
16 have without that.

17 MS. DESANTI: So Bob says he agrees.

18 MR. KEATINGE: I agree.

19 MR. CLARK: I'm sorry.

20 MS. DESANTI: Go ahead.

21 MR. CLARK: I wasn't completely articulate.

22 What we're trying to do is create something that will be
23 attractive to businesses. What we're trying to do is
24 encourage people to come into this space in a way that
25 is easy and that they're comfortable with, not that

1 imposes new burdens on them.

2 The notion that a for profit business will be
3 willing to subject itself to some kind of quasi IRS
4 scrutiny just will be the death of the concept.

5 MS. DESANTI: Heerad?

6 MR. SABETI: One quick comment. I'm certainly
7 not an advocate for onerous government oversight and
8 intervention, but I think the answer is somewhere in the
9 middle because already in the socially responsible
10 business space, there's been a couple of decades of
11 assessment tools and transparency mechanisms developed.

12 And essentially what's happening now is
13 companies shop for the best standard or they create
14 their own. They create their own label. They create
15 their own standard. There's all kinds of ways that
16 companies can basically sort of trick consumers into
17 thinking they're more responsible than they necessarily
18 are.

19 I don't know what the answer is. I think it's
20 somewhere in between. I don't think you can have an
21 onerous government process, but I also don't think you
22 can leave it up to the free markets to do it on their
23 own?

24 MR. LANG: Why you can't you leave it most of
25 this to the free markets?

1 MR. SABETI: Because the evidence so far is
2 that there's a race to the bottom.

3 MR. LANG: Nothing is perfect. But nothing is
4 perfect. Our whole society is based on a free
5 enterprise concept, that the individuals are free to
6 make choices.

7 Now, I can give you a perfect example. You know
8 that Buicks are good for drive by shootings? Why are
9 Buicks for good for drive by shootings? Because nobody
10 remembers a Buick. It's sort of a big non descript
11 blob, nice big windows and all that. You can use them
12 for drive by shootings, but unless you can prove that
13 General Motors puts gun ports in the Buicks to make them
14 especially accessible for drive by shootings, why should
15 you regulate Buicks in any way in relation to drive by
16 shootings?

17 I think that's the same thing. We can't
18 regulate everything. Stuff happens.

19 MS. DESANTI: Okay. I think the record is full,
20 is complete on this issue.

21 Now I want to go back to the hybrid entity, and
22 Elizabeth Grant, I would like to go back to you, because
23 in your discussion, I think you were highlighting this
24 tension between, on the one hand, there's a PRI
25 jeopardizing investment. On the other hand, there are

1 other investors who are getting some rate of return from
2 their investment. It may not be 20 percent, but it
3 might be 5 percent.

4 How is it that you all go through an assessment
5 of that issue?

6 MS. GRANT: Well, I don't know that charitable
7 regulators have necessarily faced that issue before
8 because traditionally, with nonprofit corporations --
9 which by the way I think there's some misunderstanding
10 that nonprofit corporations can't earn a profit. They
11 can. The one thing that nonprofit corporations can't do
12 is provide a return on equity.

13 I'm not sure, I think there should be some
14 consideration of why providing a return on equity is so
15 important and if that's really the way to fulfill
16 objectives because I think nonprofit foundations could
17 make PRI investments in nonprofits just like they could
18 make them in a for profit, so we haven't really faced
19 the issue of how much one can return.

20 Some of the hybrid forms, I know in England,
21 they have the Community Investment Corporation which has
22 asset lock restrictions so that the assets aren't going
23 to leave the charitable sector, and some restrictions on
24 the amount of profits that can be retained.

25 So far, I haven't seen those same concepts

1 incorporated into legislative proposals here in the
2 United States, so I think it raises questions about at
3 some point, the money that you're paying in private
4 distributions could be used to make the charities
5 stronger and to do more socially beneficial things, but
6 I don't know where those lines are.

7 MS. DESANTI: Elizabeth?

8 MS. MINNIGH: I just want to make the point that
9 one of the reasons that those haven't been pushed here
10 in the United States is that they're having problems
11 with them in the UK. People aren't wanting to use the
12 vehicle because of the restrictions. So the idea here
13 is to create a more flexible model that the marketplace
14 is going to want to use, and maybe it needs more
15 restrictions than we currently have in place, but if we
16 start out with so much regulation that nobody uses it,
17 it's dead in the water.

18 MS. DESANTI: Can I ask you: I know that you
19 are chairing an effort to do some expansion of the --
20 the way I understand it, and correct me if I'm wrong,
21 but what should be in the operating agreement of an L3C?
22 And I'm wondering if you can talk a little bit about
23 what else you might think about? Can you speak into the
24 microphone?

25 MS. MINNIGH: We have just started. We have

1 talked to a few people, and we're putting a group of
2 practitioners. We're putting together some people in
3 the UK that have agreed to do it, including Steven Lloyd
4 who spearheaded this, the IC movement there. We're
5 talking to some people in Canada, and we're putting
6 together a group of people, and we're going to try to
7 look at all the different models and find out what has
8 worked and hasn't worked and reach some kind of
9 consensus as to how much of this can be done by getting
10 a good model, operating agreement together or a manual
11 -- best practices sort of manual -- and how much of it
12 maybe needs a little bit of regulation.

13 We're going to try to look at -- my hope is that
14 we'll look from the extreme on both ends so we haven't
15 started yet. The answer is we're still putting together
16 the group, so that's a work in progress.

17 MS. DESANTI: Let me ask you this: Here's my
18 fundamental question about L3Cs. I understand that the
19 specific legislation, say in Vermont, says that the LC3
20 will include, as provisions in its operating agreement,
21 the same provisions that you would find for the
22 requirements for a program related investment in the
23 federal tax code; is that correct?

24 MS. MINNIGH: Yes.

25 MS. DESANTI: But what I think I just heard from

1 Lee is that there has to be -- that that's not enough,
2 that there has to be an individual comparison of the
3 purposes of the particular foundation that's involved
4 with those criteria; is that correct?

5 MS. MINNIGH: That's absolutely true. It's
6 still going to be on a facts and circumstances basis for
7 each entity. The hope is that by creating an L3C and
8 raising awareness as to what the issues are, it will
9 make it easier for foundations to identify the issues
10 they need to be looking at and to make those
11 determinations, and there will be more of a body of
12 guidance out there, but they still need to look at the
13 purposes, and they still need to make that individual
14 determination.

15 MR. LANG: I think you say you would say that
16 now exists actually for 501(c)(3) also. The 501(c)(3)
17 feeds hungry children. A foundation whose chartered
18 purpose is to support the arts is going to have trouble
19 justifying to you guys giving money to hungry children,
20 even if hungry children is an admirable trait, so it's
21 really the same rule. It's carried all the way through.

22 MS. DESANTI: Heerad, could you give us more of
23 a sense of what you've seen in other countries in terms
24 of the development of these types of for benefit or
25 benefit corporations? What I'm looking for really is:

1 What kinds of restrictions are there that other
2 countries have put on them, what other types of
3 requirements for their operation?

4 MR. SABETI: I mean, this is still a relatively
5 nascent field. There's a lot of interest. I mean, some
6 countries, I'm thinking of Singapore and some Asian
7 countries, basically see social enterprise as a way to
8 employ otherwise unemployable workers, so I think what
9 happens is everybody has a different problem they're
10 trying to solve with these new forms, and they're not
11 all trying to solve the same problem.

12 So depending on sort of where you look, some of
13 these things -- and there's a cultural context that's
14 important. In Spain, for example, co-ops are sort of --
15 there's a very famous co-op called the Mondragon
16 Cooperative. It's a large like I think billion plus
17 dollar, very successful commercial enterprise that's
18 very similar in terms of its structure to a lot of what
19 we've been talking about.

20 People have tried to replicate that model in
21 different countries and it hasn't worked because of the
22 cultural context being different, so I don't think
23 there's -- we actually did a comparative a couple of
24 years ago with Allen, there was an intern working with
25 him, of different approaches in different countries, and

1 unfortunately that didn't get as far as it could have or
2 should have.

3 But, I mean, the issues tend to be around
4 transparency, accountability. If there's going to be
5 some kind of a subsidy or incentive that the government
6 provides, then there's got to be some commensurate
7 accountability for that. The asset lock issue comes up
8 because, as you mentioned, the L3C doesn't necessarily
9 have -- I mean, if a foundation or government is going
10 to put money into an entity that can be privatized, the
11 assets for which can be privatized, that's sort of a
12 leak that could be a problem.

13 There's issues around legacy, baking in the
14 commitment to social purpose so as management and
15 ownership changes over time, the commitment is
16 preserved, so those are some of the issues that have
17 come up.

18 MS. DESANTI: This is really embarrassing. My
19 daughter as usual. Allen, I wanted to follow-up with
20 you because you have had a lot of experience working
21 with and creating these types of entities. Could you
22 give us some sense of your experience and what tends to
23 work and what tends not to work?

24 MR. BROMBERGER: Yeah, I can. First of all, I
25 start from the premise that form follows function, so I

1 agree with this notion that unless you know what you're
2 trying to accomplish, you don't know what the right form
3 is, and an L3C might be a perfect form for a certain
4 type of entity with a certain type of model and a
5 benefit core, but a CI -- all of these things are
6 designed somewhat to do different things.

7 But there's one principle that I think is at the
8 root of a lot of this here is that there's this eternal
9 tension between mission and money and between social
10 purpose and private profit, and we have in this country
11 essentially a dichotomy of business and charity, and
12 both culturally, and to a large extent from a regulatory
13 point of view, they're not supposed to touch each other.

14 Non profits are not supposed to be commercial
15 entities. They're not supposed to be formed for private
16 profit. There are limits on private inurement. Certain
17 types of activities are taxed, et cetera, et cetera, and
18 businesses are supposed to be about making money, and
19 there's a shareholder primacy document and all of the
20 things that we heard about before, and those are very
21 deeply embedded into the existing system.

22 So despite the fact that I describe myself as
23 somebody who creates hybrid organizations all the time,
24 I almost want to say there's no such thing as a hybrid.
25 There are nonprofits, most of which we tend to refer to

1 as the C3s, the charities, but there are obviously lots
2 and lots of nonprofits that are non tax exempt, and
3 businesses of various forms with various social
4 motivations, and what we find is that most of the time
5 we can't do it with a single entity.

6 What we have to do is combine a charity and a
7 business, and this is a very tricky area, and it's
8 largely unchartered waters, although there's lots of
9 guidance from the IRS over many, many years about the
10 kinds of relationships that C3s can have with for profit
11 businesses and vice versa.

12 There's a whole world of cause marketing where
13 companies want to attach themselves to charitable causes
14 and make payments to charity and have their logos
15 prominently displayed, commercial co-ventures where
16 producers of goods say a percentage of your sale is
17 going to go to charity, lots and lots of different kinds
18 of arrangements.

19 Nonprofits, charities, they buy goods and
20 services from for profits all the time. From your
21 landlord -- if you're a charity, your landlord is not
22 likely to be a C3. You're paying rent. It's a market
23 rent, and that landlord is making money off of that
24 lease, and so it's not such a clean thing, and what we
25 have is -- so what I find is that generally what tends

1 to work best, and again this is painting with a broad
2 brush, is what I would call a strategic combination of a
3 for profit and a nonprofit.

4 So that what you have is a charity, which is a
5 charity and it's a charity, and it lives under the rules
6 that apply to charities, and it behaves like a charity
7 and has to follow all the rules and regulations and file
8 all its forms with the State Attorney General and comply
9 with life as a charity, but it has access to
10 philanthropic dollars, tax deductible contributions.

11 There are ways to amass capital within
12 501(3)(c)s that can be then put to work. 501(3)(c)s are
13 allowed to -- not just private foundations with PRIs but
14 public charities, those are by far the largest number of
15 charities -- are permitted to make investments. They're
16 permitted to enter into business arrangements with
17 business, essentially as long as it's legitimately
18 furthering its charitable purpose, and they're not
19 running afoul of the inurement rules or using their
20 assets for the private benefit of individuals.

21 And the business, on the other hand, operates
22 like a business, and so it may raise its capital from
23 private investors, and it may pay a return, and it has
24 capital expenses, and the legal rules that apply to them
25 are different. The accounting rules that apply to them

1 are different. The cultural norms and expectations that
2 apply to them are very different. People don't think of
3 businesses and charities as being the same thing.

4 The real difficulty here is that we don't have
5 enough real guidance about how you can combine these
6 forms because going back to my example of content
7 creation versus distribution, I can easily imagine a
8 scenario under which you would want your newsroom to be
9 a nonprofit, and you would want that independence and
10 that integrity.

11 One of the problems that we see is that as the
12 news media has become owned by what are essentially
13 entertainment media companies, the traditional
14 independence of the editorial content and the reporting
15 has eroded, and that has an effect on how news gets
16 produced and distributed and the trust which people have
17 in the news that they're getting.

18 So the IRS has given some guidance in the area
19 of joint ventures. It is pretty restrictive, and it
20 makes it very difficult for nonprofits and for profits
21 to do joint ventures, but the trend is actually to
22 loosen those restrictions, so I think we're probably one
23 or two revenue rulings away from a place that would
24 allow a lot of the stuff to go on within certain
25 parameters.

1 The same thing is true for the State Attorneys
2 General. They understand nonprofits are economic
3 entities, and they have income, and they have expenses,
4 and they have to exist. I don't care if you're a
5 business or a nonprofit. If you're spending more than
6 you're taking in on an ongoing basis, you're not going
7 to be around very long.

8 So with that in mind, since I do get my two
9 seconds here, I actually gave some thought to some
10 incremental steps and things in terms of tax policies,
11 some areas that the IRS could look at that might help
12 give some clarity to the kinds of arrangements that are
13 permitted so that practitioners could do this more and
14 PRIs would be easy to make and all this stuff would be
15 easier to do because there would be -- right know it's
16 just totally outside of the box, and we need to kind of
17 build a box, and then it will be inside the box, and
18 everybody will be comfortable dealing with it.

19 So the first thing ironically is there's no
20 definition in the tax law of what's a joint venture,
21 which is to say there are about ten different
22 definitions that apply in all kinds of different
23 situations, okay. So there's IRS rulings that say
24 there's a joint venture, this rules applies, that rule
25 applies. None of those rulings define a joint venture,

1 so that's one place that we could begin is to actually
2 give some clarity to what these arrangements are that
3 we're talking about.

4 The second is I think charities can and should
5 have greater freedom than they do, and this is to some
6 extent related, to enter into business relationships and
7 joint ventures and strategic partnerships with for
8 profit companies, and to me the whole trick there is
9 what are the parameters of those relationships and what
10 are the permissible boundaries?

11 And I think everyone here might have a slightly
12 different version of that, and there are a whole world
13 of people that aren't at this table that would have
14 ideas about this. I'm not saying it's easy, but until
15 we have clarity and parameters as we do with PRIs and
16 with advertising with all these other things, it's very
17 difficult to see how any of this stuff really moves
18 forward in a dynamic way at any scale at all, and that's
19 certainly true of the news business.

20 The third thing which follows from that is to
21 make PRIs easier and cheaper to make because with all
22 due respect, although there's no requirement that you go
23 to IRS, foundations -- with the exception of those
24 intrepid few who are making a hundred PRIs, there's an
25 organization called PRI Makers, and it's supposed to be

1 all the foundations that make PRIs. I don't know what
2 their membership is today, but last year there was
3 something like 37 foundations that had joined it, that
4 are self identified as foundations that were making PRIs
5 on any kind of regular basis.

6 It's a tiny, tiny fraction, but it could be much
7 larger, and it could be a very good vehicle in a way to
8 move philanthropic capital into these ventures,
9 specifically to further their charitable purpose.

10 One of the thoughts that I think, which is kind
11 of in line with what Bob and Elizabeth were talking
12 about with the L3C, is thinking about some kind of safe
13 harbor, so that if you -- say if do you these seven
14 things, you're presumed to qualify, and that would make
15 the job of practitioners much, much easier because we do
16 tax opinions on PRIs, and it's really hard to do.

17 It's really -- your client is going to be
18 entitled to rely on that. If it turns out you're wrong
19 and there are all kinds of tax consequences, it comes
20 back on the lawyers. We don't write those opinions
21 lightheartedly and it takes a lot of work.

22 The fourth area is I think to clarify and
23 perhaps to give higher level guidance, a lot of private
24 letter rulings, very few revenue rulings, but a lot of
25 private letter rulings that basically say that it is

1 permissible for a charity to invest in for profit
2 ventures as a legitimate way to further their purpose.

3 So if you're a nonprofit group and you're
4 mission is to reduce greenhouse gases and you wanted to
5 enter into a partnership with a car company to develop a
6 new type of fuel cell vehicle or something like that,
7 and you looked at that and said, we want to make an
8 investment in that, that would be a terrific way for us
9 to carry our mission forward. It happens to be taking
10 place in a business context.

11 Those kinds of things, the notion that a charity
12 doesn't just have to provide free cheese for the poor,
13 which is a commonly held perception out there, not
14 amongst those of us who specialize in this area, but
15 among everybody else, very widely held. What are you
16 talking about you're doing a business, charities are not
17 supposed to do business. I think we need that -- we
18 need that to be opened up.

19 The last two things are not strictly speaking
20 legal, but I think they would help a lot. One of them
21 is I think there needs to be more outreach by the IRS
22 into the Fourth Sector, into the people who are creating
23 these businesses, to talk to them from a point of view
24 and the nonprofits that are carrying out commercial
25 activities and all these groups that are pushing the

1 edge of the envelope here to say, What are the actual
2 things that get into the way? Where would you draw the
3 line? Rather than have somebody sit in a room somewhere
4 who's very well versed in charitable law and theory, who
5 makes a set of regulations that on paper look terrific,
6 but when you get out there in the real world, nobody can
7 work with them.

8 Related to that I think is outreach to the
9 accounting profession because along side all of this are
10 all these business transactions and deals and money
11 moving hither and there and who does the 990s and who
12 does the financial reports and who has to decide how
13 these transactions are classified for tax and accounting
14 purposes? It's all the accountants, and I'll tell you,
15 the lawyers, who are pretty far behind on this stuff,
16 are light years ahead of the accountants. The
17 accountants have no idea what to do with any of this
18 stuff.

19 So I think those are some specific things. The
20 accountants, they live and die off IRS guidance and
21 AICPA guides. They won't move without it, so those are
22 whatever, six specific things where I think if we
23 focused a little bit, we could help move the ball
24 forward.

25 MS. DESANTI: Thank you. Bob and Elizabeth, you

1 wanted to talk about the Philanthropic Facilitation Act
2 that you're proposing, which I assume is some other
3 material that you think would help move this forward.

4 MS. MINNIGH: I think we've covered most of it.
5 It's making an information return, creating some type of
6 safe harbor or registration process where the IRS could
7 look at these ahead of time so people could be somewhat
8 assured that if people do what they say they're going to
9 do, as with the charity where they go and generally at
10 the beginning and say what they're going to do
11 upfront, that there would be some level of assurance,
12 and a little bit of cleaning up on making sure that it's
13 understood what the boundaries of newspapers and charity
14 is.

15 MR. LANG: Part of this, we definitely put in
16 some lines on newspapers because I think that there is
17 kind of a misunderstanding on newspapers. True, they
18 may endorse a candidate, but that's not really their
19 primary business, and to even put them into this
20 territory -- actually I always make the case that a
21 newspaper working in its own self interest would
22 actually recommend the worst candidates for election
23 because they create, good juicy scandal stories down the
24 road that sell more newspapers.

25 So lobbying and whatnot is basically a self

1 interest type of thing. I don't think newspapers are in
2 it for self interest. They're in it to stir up thinking
3 process. Editorials are designed to make the people
4 think -- let me give some further thought to this. You
5 may disagree with it, but disagreeing is --

6 MR. BROMBERGER: The IRS disagrees with it, if
7 you're a 501(c)(3). That was the question, and that was
8 the context. If you had a newspaper that's a 501(c)(3)
9 and endorses candidates, I don't even think it's a gray
10 area.

11 MR. LANG: We're trying to clear that point up
12 and say it's not. Basically what they do is not
13 lobbying. It's not in those categories, and that if
14 they got into this space, it really doesn't fall
15 within it.

16 The IRS I think also looked at newspapers a lot
17 back in the days when there was a general rule that said
18 any business that can be handled by a free market sector
19 doesn't belong being nonprofit. Nonprofit was really
20 meant to fill space that the free market economy would
21 not do.

22 I mean, Kraft is not going to go out and hand
23 out free cheese, so therefore you have to have somebody
24 that buys cheese from Kraft with donated dollars and
25 goes out and hands out the free cheese. So that's again

1 part of the burning light.

2 If you can't make 30 percent on a newspaper
3 anymore, maybe you need some other way to be able to get
4 that information out there.

5 MR. CHIARELLO: I wanted to kind of direct some
6 questions to Robert Keatinge. If you could talk a
7 little bit about your experience, I know you've worked
8 in Colorado extensively, also in corporate design, and
9 actually when you were talking about the L3C and some of
10 these through corp designs, it got me thinking about
11 from an historical perspective, maybe when we go back to
12 the days when the LLC was being designed, what problems
13 was that being designed to solve?

14 MR. KEATINGE: Well, I think it's interesting
15 listening to the discussion and how this is evolving,
16 and quite frankly, I know that Carter and bill and Steve
17 have been working in this area. I'm not sure that any
18 of them go back as far as I do to the original Uniform
19 Partnership Act when we were wrestling with the basic
20 definition: Does it have to be organized for profit,
21 and historically, as Allen has rightly stated, there
22 have been two universes.

23 There has been a for profit universe and a
24 nonprofit universe, with the exception of the corporate
25 law in Baha, Delaware, Baha, Pennsylvania, where the two

1 are in the same statute, and there's been a lot of
2 discussion about how to go about doing exactly the kinds
3 up joint ventures that Allen's talking about and how to
4 facilitate people working together.

5 What has happened is that the LLC early on was
6 adopted -- essentially it's going to be just like a
7 partnership. It will be two or more persons organized
8 for profit, et cetera, and what we discovered, working
9 on any number of statutes around country, is that rather
10 than adding additional burdens to the state law, the
11 more we took out limitations, the more effective the
12 vehicle became.

13 Carter and I did a symposium, and I talked on
14 this very subject a year and a half ago. What didn't we
15 think about when we came up with LLCs 20 years ago? One
16 of the things that nobody considered was the idea that
17 an LLC doesn't need to be organized for profit. It's a
18 contract.

19 Bill and I can agree that what we want to do is
20 build houses for the homeless or we want to render poor
21 people homeless and make a profit. Rather than saying
22 something specific in the statutes, what we ended up
23 doing was saying an LLC can be organized for any lawful
24 activity, essentially saying that the LLC is a very -- I
25 like to say an LLC is a suit that gets tailored for the

1 individual transaction. For that reason, I consider the
2 L3C to be an abomination and have said so repeatedly.

3 I think that it is neither necessary nor
4 sufficient for a vehicle to have a -- to serve as a PRI.
5 It seems to me that if, in fact, the Mannweiler
6 Foundation wanted to spend its money encouraging PRIs,
7 perhaps coming up with more education for people and
8 maybe even some form operating agreements would be
9 helpful, but the attempt to say, We're going to adopt a
10 statute that is going to make PRIs bulletproof,
11 essentially trying to change federal law through a state
12 statute, it is neither necessary nor sufficient, and my
13 reaction is that what it's doing is it's attempting to
14 mislead people into thinking they can do something
15 without accomplishing it.

16 Now? Let me contrast that -- no, no, I've
17 listened to you.

18 MR. LANG: This is a personal attack. You have
19 no right making -- first off, you're putting words in my
20 mouth. You're putting words in my mouth. You're saying
21 what our objectives were. You've never had the courtesy
22 in all the years that you've been doing this to ever
23 call me, to ever email me, to ever ask me a question, to
24 ever ask me what my purpose is or to ask what the
25 foundation's purpose is.

1 I think to sit here and just make an outright
2 attack, you are dead wrong.

3 MS. DESANTI: Okay. You've made your point,
4 Bob. Please continue.

5 MR. KEATINGE: Okay. Let me contrast L3Cs with
6 I guess it's now benefit corporations rather than for
7 benefit corporations. That approach is actually
8 attempting to solve a problem that exists in the state
9 law because the corporate world is set up with the
10 concept of having a for profit set of fiduciary duties,
11 and that's a state law issue that needs to be resolved
12 at a state level.

13 So, for example, as I've characterized it in
14 talks with Bill because we are considering for benefit
15 or benefit corporations in Colorado, what the for
16 benefit rules are doing are dealing with an issue that a
17 director in a state corporation must deal with. That is
18 as a business corporation, the corporation is organized
19 for the purpose of generating profit, and the director
20 who does something that is not generating pecuniary
21 profit runs the risk of having a state law claim of
22 waste made against them.

23 Unlike LLCs, which are based almost entirely on
24 a statutorily endorsed contract among the owners,
25 business corporations, and Bill sometimes gets upset

1 when I refer to them this way, are something of a
2 procrustean bed into which the shareholders have to come
3 without the ability to modify it by agreement.

4 What the benefit corporation is attempting to do
5 is saying, Okay, if you invest in this and you know the
6 shareholders are going to be minimizing the profits they
7 can make for the purpose of doing socially worthwhile
8 things, then where you come out is that you are saying
9 that you have bought into the fact that this may look
10 like waste because you could have made more money, say
11 using inferior products or underpaying workers or what
12 have you, but we recognize that you're making this part
13 of what the organization is designed to do.

14 I think that by giving that sort of flexibility,
15 what that does is that appeals to me in the newspaper
16 area. I have absolutely no use for more pieces of paper
17 as those of you know me can attest, but I was afraid of
18 losing the Denver Post, and so I went out and I entered
19 into an electronic subscription with the Denver Post,
20 for which I paid, even though I could have gotten the
21 same thing for free.

22 I wanted promote this sort of thing, and this
23 allows corporations to make that kind of decision and
24 not put the directors in the position where they run the
25 risk of having claims of waste being asserted against

1 them.

2 In summary, it seems to me that a lot of what I
3 see as being the most helpful thing that the state law
4 organizations can provide, and like Bill I know and most
5 people here, we strongly believe in the federalist
6 approach that the state should draft business
7 organization law.

8 In this area, because it is so federally tax
9 sensitive, be the joint ventures between hospitals and
10 doctors or PRIs, that the best thing that state laws can
11 do is to get out of the way and afford maximum
12 flexibility, letting both the state and federal
13 regulators regulate the tax rules.

14 Now, there's a second question that comes up,
15 and that is: Should the state get into the area of
16 branding? And quite frankly, I have some reservations
17 about that, just because unless you get to the point
18 where the state is going to actually come up with a
19 truly pervasive branding and enforcement scheme, which
20 is going to put some fairly significant burdens on the
21 state's tax coffers, which at least in Colorado we don't
22 have, it seems to me that branding is far better done by
23 independent organizations who can develop their own
24 brand, can basically collect the money that they need to
25 collect from those who wish to obtain the branding, be

1 it the Underwriters Laboratory or the B Corp.

2 It seems to me that until you can find a way to
3 subsidize making the branding mean something at a state
4 level, it's misleading to put state branding into state
5 statutes. There are better ways to do that, but that's
6 my perspective on this.

7 MS. DESANTI: Okay. Thank you. Carter, do you
8 have anything else you want to add?

9 MR. BISHOP: Well, generally I think that my
10 view is that there are -- this is saying what Allen said
11 I suppose in a slightly different way. There are
12 virtually no restrictions other than owner greed that
13 restrict private enterprises from being more charitable
14 mission sensitive, so I think that's what Bill's effort
15 in the B corporation is attempting to do.

16 What Bob is trying to do is a highly more
17 sensitive area because of the federal regulations. It's
18 attempting to access public capital that has become
19 public through a tax exemption process, and so I think
20 that as Allen says, unless and until the federal
21 regulations change from this two pot view of for profits
22 and not for profits, and if you're really not for
23 profit, you're really nonprofit, and the only way that
24 you can combine or hybridize that effort is to go
25 through a series of laborious hops that you don't

1 otherwise have.

2 Then we have a problem, and it is actually far
3 worse I think for private foundations than it is for
4 public charities because historically, I think private
5 foundations, as Bob mentioned in his introductory
6 remarks, are a lot more difficult because of the control
7 that private investors had over creating their own
8 foundations.

9 The level of abuse was larger, I think that
10 Elizabeth would agree, or the potential abuse was
11 greater and so to police that, the statute inserted a
12 series of excise taxes which have that sort of role.

13 So when you talk about the PRI as a funding
14 source, you have abandoned the policing that's going on
15 first by the private foundation, and secondly by the IRS
16 over the foundation, and in addition to that, maybe
17 state authorities as well.

18 So you have some heavy layers of regulation, and
19 the cork is at that area, and I think Allen is right.
20 If you want to create a more viable flow of capital from
21 the exempt organization area, which is another form of
22 public funding, then you have to think through that
23 model and how you want to do it.

24 MS. DESANTI: We are actually over time, but
25 does anybody else have anything they want to add?

1 I want to thank Gus Chiarello, who is sitting
2 next to me who actually had conversations with all of
3 you people because he's the one who put this all
4 together, and just as the person who knows nothing and
5 therefore is most qualified to say, wait, I don't
6 understand this, let's start here, so thank you very
7 much, Gus, for pulling all these wonderful people
8 together.

9 I really appreciate this. This is probably --
10 certainly for those of us who are trying to figure out
11 journalism type issues, this is the most explanatory
12 conversation that we've heard, and it's very helpful so
13 we appreciate it. Thank you.

14 (Applause.)

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