

**ONLINE ENTERTAINMENT AND COPYRIGHT LAW:
COMING SOON TO A DIGITAL DEVICE NEAR
YOU**

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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**ONLINE ENTERTAINMENT AND COPYRIGHT
LAW: COMING SOON TO A DIGITAL DEVICE
NEAR YOU**

TUESDAY, APRIL 3, 2001

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 10:06 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Orrin G. Hatch, Chairman of the Committee, presiding.

Present: Senators Hatch, DeWine, Brownback, Leahy, Feinstein, Schumer, Durbin, and Cantwell.

**OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S.
SENATOR FROM THE STATE OF UTAH**

Chairman HATCH. Good morning, and welcome to today's hearing entitled "Online Entertainment: Coming Soon to a Digital Device Near You." That is kind of a long title. There have been a number of significant developments since the Committee's hearings last year on online entertainment and copyright law. Among many, let me mention three:

First, the Ninth Circuit has ruled that at least as a preliminary matter, Napster as we have known it cannot continue. For them, as Mr. Henley might say, it has been "The End of the Innocence." Even Napster acknowledges that this is so. And in its alliance with the forward-thinking Bertelsmann, Napster has pledged to reinvent itself so that the technology and music fan community it has unleashed can work together in a way that respects copyright law and the rights of creators. It has been suggested that this new Napster can be online in June, or at the latest, July.

Second, MP3.com has settled its litigation with the large record labels and publishers and yet, having paid damages and been granted licenses to go forward, still cannot bring its service to the public. As Ms. Morissette might question, isn't it "Ironic"?

And, third, but by no means least, several significant market developments have been announced that seem to put us a step closer to the "celestial jukebox." One was reported in last Friday's Wall Street Journal that two of the five major labels, Vivendi-Universal and Sony, were moving toward launching a consumer online service called "Duet" which will bring their joint catalogs to consumers. And the second, and even more significant, announcement was yesterday's deal between three of the big labels—AOL Time Warner, Bertelsmann, and EMI—and the independent music service pro-

vider, Real networks, to bring a subscription music service to consumers over the Internet.

Pro-competition marketplace solutions that provide for a significant online offering of popular music delivered to consumers through an entity not controlled by the labels has been the type of positive synergy that I have long hoped to see. And I hope to learn more about the details of these developments and to hear more heartening information on this front. This Committee is here today, and will continue in the future, to monitor these and related developments in our ongoing efforts to ensure that our intellectual property laws keep pace with technology.

Technology has made our lives more convenient, but it has also made us more impatient. When a consumer drives up to a gas pump, she can insert her credit card, confirm that she has adequate funds in her account, her account is debited, and the oil company's account is credited, the transaction is completed, the consumer is thanked, and the tank is filled. All of this occurs within a matter of seconds, and the transfer of sensitive financial data is done so securely and with utter precision.

Now, while there are significant additional challenges in the context of a product that is delivered wholly online, most consumers think similar technological advances should allow them access to the music and the movies they love whenever and wherever they want it. I believe it can, and that it can do so in a way that respects the rights of those who create the works we all want to enjoy in this new way. Instant access to an infinite offering of perfectly performed creativity on a portable device the size of a pen, or a phone, or in the car, or wherever I want it, without dragging cases of CDs, is more than a new way of delivering the same product. It is a transformation of our experience of entertainment and poses a revolution in the businesses that have delivered it. And I do appreciate the disconcerting panic that the uncertainty of new technology might cause established businesses such as the record labels.

But as a music lover, and as one who enjoys the best that human creativity offers, I—and fans across this country—eagerly anticipate these technological transformations the future holds. That is why we are here today. As inventor Charles Kettering admonished, “We should all be concerned about the future, because we will have to spend the rest of our lives there.” Artists, record labels, and music fans.

The developments I mentioned have involved primarily entertainment companies and technology companies. But as Mr. Henley has pointed out, “there’s three sides to every story.” Today, we may find there are even more sides than that. We have tried to broaden the discussion beyond just the business entities that mediate the primary relationship. We need to keep in mind in this process that between the artist and the audience. We need to look to see what the future of these various industries holds and how technology has and will continue to change it.

When it comes to technology, I must admit, I try to avoid making any predictions. Whenever I am tempted, I think back to the year 1927, when H.M. Warner of Warner Brothers said, “who the hell wants to hear actors talk?” Or more recently in 1977, when Ken

Olsen, the founder of Digital Equipment Corporation, said, "there is no reason anyone would want a computer in their home."

But what I can safely predict is that we will have no choice but to embrace technology, and in order to do this properly, especially as policymakers, we need to understand it. And that is precisely why I am pleased to have such a large and distinguished group here today sharing their thinking with us about these matters. As many as are here, many were not able to participate because of space and time constraints. We will include in the record many statements from a number of artists and technology companies and others. Joining us today are leaders in the entertainment and technology businesses, as well as consumer advocates and some of the most distinguished creators of popular music. I look forward to learning from each perspective presented today.

I will conclude by saying that some may feel about the road ahead as Woody Allen expressed it: "We stand at a cross-roads, one road leading to despair and hopelessness, and the other leading to extinction, and I hope we have the wisdom to choose correctly." He has a way of putting things.

Well, I am optimistic that we will be able to choose the road that embraces technology, respects the creativity of artists, and meets the justifiably impatient demand of consumers. With apologies to Ted Nugent, who, unfortunately, could not make it today, I do not believe that we are riding a "Terminus Eldorado." Rather, I like to take the advice of Alanis Morissette, with whom I met this morning, who suggested on her last album that the appropriate response to experience, even to experience we don't particularly want, is a resounding "Thank U." I believe the road ahead is very exciting. I do know some things about this, but I do not know precisely where it leads, nor will I predict, but I can see some exciting possibilities. And I look forward to exploring them with all of you today.

This is an important hearing. It can help to determine where we are going in the future. And we have some of the most important people on earth here today with regard to the issues involved, the complex issues and the contradictory issues that are involved, and we look forward to hearing from all of you.

Senator Leahy?

**STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR
FROM THE STATE OF VERMONT**

Senator LEAHY. Thank you, Mr. Chairman. When I see a crowd this size, I wonder whether you must be giving away something free.

[Laughter.]

Senator LEAHY. I will just let that one float out there with no editorial comment.

I am glad to see my friend Don Henley here. The last time we were together it was a little bit quieter venue, but I am not going to be photographing you here. We have the best photographers in the country lined up here. I will let them do that.

Technology changes have become almost exponential in the last few years. When I arrived in the Senate 26 years ago, Mr. Valenti remembers I not only had hair but it was dark at that time. But when I arrived here 26 years ago, I installed what was the latest

technology—and I was the first Senator in the country ever to do this—to make it easier for my constituents to contact me. That technology was an 800 telephone line, the first Senator ever to have done that. It was the latest and best technology.

Now, look at the difference. I still have the 800 number, but I get a lot more e-mails from my constituents than I do telephone calls. I get them day and night and so on. In fact, I get sometimes more e-mail messages than the antiquated Senate computer system is able to handle. And when the computer systems here in the Senate are temporarily shut down because of too much of a good thing, we realize quickly how dependent we are on them.

Now, this Committee examined the challenges to the music industry posed by new online technologies at a hearing almost a year ago. I am glad to see back before the Committee some of the same witnesses who testified at last year's hearing and to welcome the other witnesses Senator Hatch has invited.

Music has been at the forefront of the online copyright battles, but the issue raised by the deployment of new software applications and new online services have even broader implications for other forms of copyrighted works.

For the copyright industry, to paraphrase a classic phrase from a book I first read back in the third grade, one of my favorites, "It is the best of times, it is the worst of times. It is the age of wisdom, it is the age of foolishness."

These are certainly good economic times for our copyright industries. Computer software, motion pictures, television programs, music, publishing, other copyright-based industries have proven to be a critical engine for our economy. According to one recent study, American copyright industries accounted for almost 5 percent of our gross domestic product. To put that in actual numbers, that is over \$450 billion. And employment in this sector grew more than three times as fast as the remainder of the fast-growing U.S. economy.

In the same year, 1999, the U.S. copyright industry led all other major industry sectors with over \$79 billion in foreign sales and exports. That is more than the automobile, the car parts, the aircraft, or the agricultural sector. That is a big change from when I came to the Senate.

The growth of these industries has been good for American workers. It has been good for our economy. And their continued success depends on strong copyright laws and effective enforcement of these laws.

Every year, the copyright industries lose billions of dollars in lost revenue to hard goods piracy around the world. According to Forrester Research, one pirated product is made for every three legitimate ones. Think of that. A quarter of the products are pirated.

Now, understandably, especially in a digital age, software manufacturers, the record companies, the movie producers, the retailers, whose business is selling licensed copies of these copyrighted works, are concerned that the losses are going to accelerate as digital works are downloaded freely and without consideration to the owners of these products.

Over the past years, Senator Hatch and I and others on the Judiciary Committee have worked constructively and productively to-

gether. We have tried to provide a legal framework to protect our country's intellectual property. We have worked hard to craft intellectual property legislation that fulfills the promise of our Constitution, not simply to secure rights for authors and inventors, but do it in a way that promotes the progress of science and the useful arts.

Now, we also strive to ensure that copyright law protects fair use and free speech and promotes consumer choice and technological innovation.

Our past history has shown that oftentimes new technologies may initially appear to trump intellectual property protection, but in the end, they usually open new opportunities for artists and new sources of revenue for the copyright owner and new choices for consumers. I can understand how artists and writers can be worried. I went on to a site—not Napster, I should point out—but I downloaded Don Henley, I downloaded “Annabel,” “Damn It, Rose,” “Everything Is Different Now,” “For My Wedding,” “Goodbye to a River,” “Inside Job,” “Miss Ghost,” “My Thanksgiving,” “Nobody Else in the World But You,” and others. I picked those because they are among my favorites. For Ms. Morissette, I saw, again, ones I enjoy very much, “All I Really Want,” “Forgiven,” “Head Over Feet,” “Ironic,” “Mary Jane,” “Perfect,” “Wake Up,” “You Learn.” I am just looking at the computer here.

Now, most of those I have at home, the CDs that I bought at a store and have enjoyed. I can imagine, though, probably some of the calculations that are going on in your mind as I read down these. But I am also reminded of the battles in the early 1980's of the videocassette recorder. As recently documented in the new book, *Digital Copyright*, the motion picture industry initially predicted that the invention and marketing of the VCR would lead to the destruction of the American television and motion picture industries. Indeed, a representative of the American Federation of Television and Radio Artists told a Congressional Committee back in 1982, that, “Unless we do something to ensure that the creators of the material are not exploited by the electronics revolution, that same revolution which will make it possible for almost every household to have an audio and video recorder will surely undermine, cripple, and eventually wash away the very industries on which it feeds and which provide employment for thousands of our citizens.”

As one commentator recently observed, “Both the motion picture and television industries discovered that the videocassette recorder generated new markets for prerecorded versions of their material.” In fact, I don't think there is a movie—and Mr. Valenti would know this better than all of us—if there is a movie made today where they don't think what the after-sale aspects of video or DVD recording might be.

I think the VCR's history of success will repeat itself in this new era. The copyright industries appear to have learned from this history. They are making efforts to develop new business models that will flourish in the digital environment. We want to hear from entertainment companies and online service providers and retailers about what they are doing to provide legitimate sources of copyrighted works online and what obstacles remain.

Now, the courts have ruled on the application of copyright law to Napster's operation. There are additional court hearings in that case next week. And whether I agree or disagree with what the court is doing, this is not the place to relitigate that case or the MP3.com case.

At our last hearing, each witness was asked about Congress' role here. Each witness then—and some of you are here today—stated clearly that no Congressional action was wanted or needed and that the marketplace was the right place to resolve these matters.

So I am going to be interested in hearing how the marketplace is evolving, how we make the best of these times, but also how we ensure those people who are such superb artists and writers and performers are able to be compensated for their work, because as much as I love new technology—I don't think anybody else uses new technology any more than I do up here, I don't want Don Henley or Alanis Morissette or anybody else to not be able to continue to produce because they are not being compensated for their work.

So let's figure out how we do such things. I mean, how do we protect the genius of those who do this, but also the genius of those who have designed everything from Napster to MP3.com. In other words, how do we use the technology and balance the rights of all creators of copyrighted works.

Thank you, Mr. Chairman.

Chairman HATCH. Thank you, Senator.

We have a long and distinguished list of witnesses today, and in the interest of time, I will give the barest of introductions to each witness before they begin each of their presentations.

On the first panel, we will hear first from Richard Parsons, who is the co-chief operating officer of AOL Time Warner, one of the world's premier entertainment companies.

Jack Valenti is no stranger to this Committee as Chairman and CEO of the Motion Picture Association of America. We certainly welcome both of you here and look forward to hearing your testimony.

Don Henley is a leading advocate for artists and is a world-renowned writer and artist in his own right. I have a great deal of respect for Don Henley, and we are very pleased to have you with us.

Alanis Morissette is similarly one of the most popular artists in the music industry and music business today, and it was really a pleasure to get acquainted with you, Ms. Morissette. We are very appreciative that you would take time to be with us.

Hank Barry, as you all know, is the interim CEO of Napster, the music file exchange service, which has been some of the cause of this excitement we have had around this over the last number of years.

Steve Gottlieb is president of TVT Records, a large independent record label. We are grateful to have both of you with us and look forward to your testimony.

Ken Berry is president and CEO of EMI Recorded Music and which, of course, is one of the premier companies in the business. We appreciate you taking time to be with us, Mr. Berry.

Gerald Kearby is president and CEO of Liquid Audio, an online music delivery and technology company. Mr. Kearby, we are very happy to have you here.

And, finally, no stranger to this Committee and someone who has helped us through the years to understand some of these issues, Hilary Rosen, who is president and CEO of the Recording Industry Association of America. Ms. Rosen, as always, we look forward to hearing your testimony.

We look forward to all of your presentations here today, and in the interest of time, we would ask each of you to summarize your presentations if you can and do it in as fast a summary as you can.

So we will start with you, Mr. Parsons, and go right across the table.

STATEMENT OF RICHARD D. PARSONS, CO-CHIEF OPERATING OFFICER, AOL TIME WARNER

Mr. PARSONS. Mr. Chairman and members of the Committee, thank you very much and good morning. In view of the long list of speakers, I will try to set an example, if not of eloquence then at least of brevity. But even in the interest of brevity, let me not forget good manners. Let me thank you, Mr. Chairman, for inviting us here to speak today. And thank you also for the leadership that you and Senator Leahy and the other members of this Committee have provided in this area of not only superintending the rights of copyright owners, but looking out for the interests of consumers as we enter this digital age. We appreciate your thoughtful efforts in trying to help shape public policy to protect both important interests.

Also, I would be remiss if I didn't call out—this is a distinguished panel, but just join you in expressing appreciation for two of the members of the panel in particular: Don Henley and Alanis Morissette. In our business it is complex and it is growing more so, but we understand that at the core of the creative side of our business is the creative genius of artists who make it go. It all starts with them, and while on occasion—and you may hear some of it today—we have internal fusses and feuds and family fights, these are two artists who are associated with our labels, and we couldn't be prouder of them, and we want to acknowledge that we acknowledge that at the end of the day it starts with their creative genius, and the rest of us just kind of build on that.

So, with that, let me say that as co-chief operating officer of AOL, I am in charge of what we refer to as our "content businesses." Behind that somewhat sterile label are four of the world's most creatively dynamic enterprises: the Warner Music Group, Warner Brothers Studio, New Line Cinema, and Time Warner Trade Publishing.

Together, these businesses produce an extraordinary array of movies, music, television programming, and books. Today they are also grappling with the effects of digital media in general and the Internet in particular, the very stuff which this hearing is intended to address.

Now, I won't try and explore all of the implications of the digital revolution for our company or for our industry, both because I

would be here all day if I tried and, more fundamentally, it is a universe still evolving on a minute-to-minute basis.

Instead, let me offer three basic observations that I believe past and present experience suggests might guide our way as we enter the new digital age.

First, we know that the digital distribution of entertainment content is a real business and that it will grow exponentially going forward. As my friend and partner in crime at AOL Time Warner Bob Pittman puts it, “How often do you launch a business where you know millions of consumers are already lined up and waiting for your product?”

Because we recognize this, we also recognize that the digital age presents a tremendous opportunity to our company to bring new levels of convenience and choice to consumers, to develop new artists, and to expand the market for creative content. Those companies that can meet these criteria and meet this challenge will succeed in the new digital marketplace. Those who can’t, won’t.

Second, we know that where there is no effective copyright protection, there are no creative enterprises, save those directed by wealthy patrons or government. This is as true in the digital world as it was in the analog one.

Quite simply, a vibrant, vital democratic culture can’t exist without the legal right of individual artists and the enterprises that nurture, develop, and distribute their work to direct how and where it is to be used and to reap the rewards therefrom.

In the end, I think anyone who wants to be a part of a business involving copyrighted material must respect the copyrights of others, not merely out of respect for the law, but out of the simple requirement of survival.

If the history of America’s economic success has taught the world anything, it is the indispensable role of a system of law in creating a marketplace where buyers, sellers, and producers can be certain of their rights and responsibilities.

Like free governments, free markets are impossible to sustain without the collective willingness to observe and enforce the legal safeguards that ensure that the pursuit of happiness doesn’t descend into mass piracy and anarchy.

As inconvenient as it may be for some, the legal right and moral necessity of intellectual property protection can’t be conjured out of existence by the wave of a digital wand. Either we abide by the rule of law or we end up with chaos.

Third, when it comes to the shape, substance, and operation of the digital marketplace, none of us knows what future format it will take.

Put aside the logical absurdity of trying to write regulations for an industry that doesn’t even exist yet, and consider what is the best way to ensure that consumers get to decide in what form and at what price they receive information and entertainment on digital networks.

The answer, I submit, is fairly simple: strong, market-drive competition. Along with guaranteeing copyright protection, our shared focus should be on fostering an environment that secures a marketplace in which consumers have an optimum array of different and convenient choices for quality and value.

Now, yesterday, as you mentioned, Senator, our companies took a big step in that direction with the announcement of an agreement to form something called MusicNet, which is a collaboration between AOL Time Warner, RealNetworks, EMI, and Bertelsmann. It is a breakthrough platform for online music subscription services in both a safe, convenient, and lawful manner. This agreement ushers in, we believe, the era of secure, convenient, interactive mass music distribution that consumers demand that we want to provide. By licensing our music catalogues to MusicNet, we create new outlets for our artists and for their work. By distributing a MusicNet-powered subscription service on AOL, we can offer the best interactive music experience for our online members, allowing them to choose from a broad selection of different labels and artists.

In conclusion, I would say that amid all the views you will hear today, it is my hope we can reach consensus on these three facts: digital distribution is here to stay; copyright is key to making it fair for consumers and creators alike; and competition and consumer choice are the way to ensure a continuing supply of high-quality content at affordable prices.

Thank you very much.

[The prepared statement of Mr. Parsons follows:]

STATEMENT OF RICHARD D. PARSONS, AOL TIME WARNER

Chairman Hatch and the Members of this Committee, I'm Richard Parsons, Co-Chief Operating Officer of AOL Time Warner, and I'm Grateful for the Chance to appear here today.

In view of the long list of speakers, I'll try to set an example, if not of eloquence, then of brevity.

As Co-Coo, I'm in charge of what we refer to as our "Content Businesses." Behind that somewhat sterile label are four of the world's most creatively dynamic enterprises: Warner Music Group, Warner Bros. Studio, New line cinema and Time Warner Trade Publishing.

Together, they produce an extraordinary array of movies, music, television programming and books. Today they are also grappling with the effects of digital media in general and the internet in particular, the very issues this hearing is intended to address.

The merger of AOL and Time Warner has put the timetable for change on hyper-speed. I won't try to explore all the implications for our company or industry, both because I'd be here all day and, more fundamentally, It's a universe still evolving minute to minute.

Instead, let me offer three basic observations that, I believe, past and present experience tells us to be true.

First, we know that the digital distribution of entertainment content is a real business and will grow exponentially. As my friend and partner Bob Pittman puts it, "How often do you launch a business where you know millions of consumers are lined up and waiting for your product?"

This is a tremendous opportunity to bring new levels of convenience and choice to consumers, develop new artists and expand the market for creative content. Those companies that can meet these criteria will succeed in the new digital marketplace; those who can't, won't.

Second, we know that where there's no effective copyright protection, there are no creative enterprises, except those directed by wealthy patrons or government. This is as true in the digital world as it is in the analog one.

Quite simply, a vibrant, vital democratic culture can't exist without the legal right of individual artists and the enterprises that nurture, develop and distribute their work to direct how and where it is used, and to reap the rewards.

In the end, I think, anyone who wants to be part of a business involving copyrighted material must respect the copyrights of others, not merely out of respect for the law, but out of the simple requirement of survival.

If the history of America's economic success has taught the world anything, it's the indispensable role of a system of law in creating a marketplace where buyers, sellers and producers can be certain of their rights and responsibilities.

Like free governments, free markets are impossible to sustain without this collective willingness to observe and enforce the legal safeguards that ensure "the pursuit of happiness" doesn't descend into mass piracy and anarchy.

As inconvenient as it may be to some, the legal right and moral necessity of intellectual property can't be conjured out of existence by the wave of a digital wand. Either we abide by the rule of law or we end up with chaos.

Third, when it comes to the shape, substance and operation of the digital marketplace, none of us knows what future forms it will take.

Put aside the logical absurdity of trying to write regulations for an industry that doesn't even exist yet, and consider what's the best way of ensuring that consumers get to decide in what format and at what price they receive information and entertainment on digital networks.

The answer is simple: strong market-driven competition.

Along with guaranteeing copyright protection, our shared focus should be fostering an environment that secures a marketplace in which consumers have an optimum array of different and convenient choices for quality and value.

Yesterday, we took a big step in that direction with the agreement by realnetworks, EMI, Bertelsmann and AOL Time Warner to create musicnet, a breakthrough platform for online music subscription services.

This agreement ushers in the era of secure, Convenient, interactive mass music distribution that consumers demand and that we want to provide. By licensing our music catalogues to musicnet, we create new outlets for our artists and their work. By distributing a musicnet-powered subscription service on AOL, we can offer the best interactive music experience for our online members, allowing them to choose from a broad selection of different labels and artists.

Amid all the views you'll hear today, it's my hope we can reach consensus on these three facts: digital distribution is here to stay; copyright is key to making it fair for consumers and creators alike; competition and consumer choice are the way to ensure a continuing supply of high-quality content at affordable prices.

Thank you.

Chairman HATCH. Thank you.

Mr. Valenti, we will turn to you.

STATEMENT OF JACK VALENTI, CHAIRMAN AND CHIEF OPERATING OFFICER, MOTION PICTURE ASSOCIATION OF AMERICA

Mr. VALENTI. Thank you, Mr. Chairman. I brought with me my timer so that I can be sure that I am not going to filibuster, which is an attitude devoutly to be admired by all.

Chairman HATCH. We forgot to put ours up, but I have asked them to get it. But we are going to give you time.

Mr. VALENTI. Let me start by saying that the copyrights industries, which are composed of movies, television, home video, music, publishing, and computer software, represent America's greatest economic asset, and, I might add, its premier export trade prize. We are creating new jobs at three times the rate of the remainder of the economy. We bring in more international revenues than agriculture, than aircraft, than automobiles and auto parts. We have a surplus balance of trade with every single countries in the world. No other American enterprise can make that statement. That is a revelatory statement because last year this country suffered over \$400 billion in deficit balance of trade. We are an economic engine of growth that is the envy of the known world.

More extraordinary is the reach, the global reach of the copyright industries. That creative material is joyously received by every country, creed, and culture, and the American movie, as anybody

who travels abroad would testify, is omnipresent. We are hospitably patronized on every continent.

Now, I want you to know that we believe the Internet represents a glorious new potential of a new delivery system so that we can bring movies to American homes. I am pleased to report to you that within 4 to 6 months, several of the major film studios will be on-line with movies, and the other major studios will follow close on their heels. We are using new technology to try to protect these movies on their journey from cyberspace to American homes, to prevent wholesale reproduction as well as retransmission on the Internet. But if that protection is not enough and we need more technological protection, some of which will require Congressional legislation, we will be back to you to ask for your help in protecting America's most precious creative prize.

I think that Congress has to stand guard to preserve, protect, and defend copyright, without any question, against those who want to erode it or shrivel it or exile it.

Now, I might add that new technology makes possible through the Internet people to illegally download movies today without permission of the owner and without any payment.

Now, creative property is private property. To take it without permission and without payment collides with the core values of this society, and otherwise rational people, who wouldn't dream of stealing a videocassette off the shelf of a Blockbuster store, blithely download movies casually, which seems to be for many accepted normality of Internet behavior.

Now, I will tell you again, to repeat, that creative property is private property. Right now consultants tell us that at least 350,000 movies are being illegally downloaded every day right now, with estimates up to 1 million downloads illegally within the year. So, again, creative property is private property. To take it without permission or payment just because technology say it is easy to do so is wrong.

Now, with all the passion that I can summon—and I am about to deplete it right quick—I am asking this Committee and the Congress to make sure that copyright is not allowed to decay, for if that happens, this Nation will see the slow undoing of an enormous creative and economic asset, and we will be squandering part of that economic future.

So I will utter three words that will thrill this Committee: In conclusion—that is Goldwyn, “in conclusion.” Well, forget it, I won't go into that.

[Laughter.]

Mr. VALENTI. But I want to leave you with this question: Who will invest huge sums of private risk capital in the production of films if they cannot protect that creative material from being stolen on the Internet, or anywhere in cyberspace? That is the question I leave with you, and I share Mr. Parsons, and I hope some of the other people on this panel, of the eternal enduring value of copyright as a great, great asset of this country.

Thank you.

Chairman HATCH. Well, thank you. I think—

Mr. VALENTI. Mr. Chairman, let me ask you a question. I am under 5 minutes. I would like to take 32 seconds—and I mean 32

seconds—to show you on this screen an actual take-down, an illegal take-down that we did in our office of the picture that won the Academy Award for Best Picture while it was still playing in the theaters. I want you to see this actual take-down, if one of my experts will come over here. This is where—

Senator LEAHY. I will do it for you, Jack, if you want.

Mr. VALENTI. But I want you to see this. This is the actual take-down, Mr. Chairman, of and I am going to spin it for 32 seconds to show you the watchable quality of “Gladiator.”

[Video shown.]

Mr. VALENTI. That is what is happening today. The award-winning “Gladiator” is one of those 350,000 films that are being downloaded.

Senator LEAHY. We also thank Allison for getting it downloaded.

Mr. VALENTI. Thank you very much.

[The prepared statement of Mr. Valenti follows:]

Jack Valenti, Chairman and CEO, Motion Picture Association, Washington, D.C. When Abraham Lincoln first ran for Congress, he began his first campaign speech by saying: “My politics are short and sweet, like the old woman’s dance.” Taking my cue from Abe Lincoln, I say: “My message is short and sweet—and urgent.”

The Copyright Industries (movies, TV, home video, music, publishing and computer software) are America’s greatest trade prize. We are creating jobs at *three times* the rate of the rest of the economy. We bring in more international revenues than aircraft, more than agriculture, more than automobiles and auto parts. What is more astonishing and more valuable is that we have a *Surplus Balance of Trade with every single country in the world*, while in 2000 this nation suffered an unholy rise to almost \$400 Billion in *Deficits*. No other American business enterprise can make that statement, which is why we represent an economic engine of growth that is the envy of the known world.

Even more extraordinary is the global reach of the Copyright Industries. American creative material is joyously received by every country, creed and culture on this planet. The American movie, as anyone who travels abroad can testify, is omnipresent all over the world, hospitably patronized on every continent.

We believe the Internet has great potential as a new delivery system for movies. Several movie studios will be OnLine with their films within four to six months. They will be content encrypted, to protect these films on their way to American homes. If it becomes clear that more protection is needed, some of which might require congressional legislation, we will return to you for help.

Keep in mind it that the preeminence of the Copyright Industries as an American economic and creative prize is the prime reason why the Congress must stand guard, to preserve and defend Copyright against those who would loosen its protective bindings, or try to shrink it, or erode it. New technology makes possible, through the Internet, the illegal use of creative material without the permission of the owner nor any payment for its use. Creative property is private property. To take it without permission, without payment to its owners, collides with the core values of this society. Yet that is precisely what is happening. Otherwise rational people who would not dream of stealing a videocassette off the shelf of a Blockbuster store are using movies without permission or payment, which is, for many, the assumed normality of current Internet behavior. It is estimated that today some 370,000 movies are being downloaded, illegitimately, *every day*. By the end of the year it is estimated that one million illegal downloads will take place *every day*.

To repeat, creative property is private property. It cannot be casually pilfered simply because it is easy to do so. Moreover, with all the passion I can summon I tell this Committee that if Copyright is allowed to decay, then this nation will begin the slow undoing of an immense economic asset, which can squander our creative future. *The question that the Congress must answer is: Who will invest huge amounts of private risk capital in the production of films if this creative property cannot be protected from theft?*

Chairman HATCH. Well, thank you, Jack. That is a powerful statement, and I agree with you on copyright issues, there is no question about it, and you as well, Mr. Parsons.

Mr. Henley, we look forward to your very important comments about your industry.

**STATEMENT OF DON HENLEY, ON BEHALF OF THE
RECORDING ARTISTS COALITION**

Mr. HENLEY. Thank you, Mr. Chairman. I am certainly honored to be here today, and I appreciate the opportunity to speak today on behalf of recording artists and, more particularly, the Recording Artists Coalition, of which I am a co-founder.

Recording artists have for far too long been insufficiently represented here in Washington. I think you would agree with that. Chairman HATCH. I do.

Mr. HENLEY. The RIAA, Recording Industry Association of America, does not speak on behalf of recording artists, even though they have given the impression at times that they do. The RIAA speaks only on behalf of its membership, which is solely composed of major and independent record companies.

Now, over the next several years, Congress and the Copyright Office and the record companies and the Internet companies will lay the groundwork for intellectual property rules and royalty rates for the exploitation of music on the Internet. At this point there has been little input from the recording artist community. Most, if not all, of the discussions have been between the labels and the Internet companies.

I would like to point out that there would be no need for these discussions if it were not for artists and their creative works, and we must be actively involved in the development of this framework or our interests will not be protected. And so artists today are simply asking for a place at the table.

As you know, Mr. Chairman, the Recording Artists Coalition was at the forefront of the initiative to repeal the work-for-hire legislation that was enacted in November 1999. I would like to thank you and the other Senators on the Committee for repealing that legislation. In the past, copyright law amendments have been enacted only after serious and, at times, lengthy deliberations. Generally, all of the interested parties were afforded an opportunity to present their views to Congress. No copyright law amendment has ever passed without this type of fair and democratic deliberation, except this most recent amendment.

Before the passage of the amendment adding sound recordings to the list of works eligible for work-for-hire status, Congress heard only one viewpoint, which was that of the RIAA. You were told that the amendment was a technical change when, in fact, it was a substantive change, one that would have deprived recording artists of the right to pass to their families and heirs the lifeblood of their careers: their sound recording copyrights. Once you recognize this surreptitious manipulation, you set out to right the wrong, and recording artists and their families will never forget your courageous and principled stand.

But we are here today to discuss the digital music marketplace and what action, if any, Congress must take to meet the needs of the creators and consumers. The Recording Artists Coalition's position is very simple. We believe that recording artists should always be paid for the exploitation of their sound recordings on the Inter-

net, unless the recording artist makes the decision to provide his or her recordings free of charge to listeners.

Napster has stated in public that it intends to build a fee-based service that compensates creators. We look forward to the implementation of that service, and services like it. We recognize that, whether we like it or not, Napster has changed everything. We are listening to our fans. Millions of people have begun to experience interactive music services, and they have so far been getting these services free of charge. But I agree with Napster that, with some improvements, many of its users will be willing to pay for this sort of service. In fact, according to Mr. Barry, 70 percent of people surveyed said that they are willing to pay for this type of service.

Napster and other locker-type systems have flourished because the record industry has failed to be forward-thinking and has made it extremely difficult for legitimate companies to license rights on an arm's-length basis. The record industry has fiddled on the sidelines while the digital revolution went on without them. The major labels should have spent their time negotiating and implementing a fair and comprehensive licensing system, one that addresses the interests of all parties, including recording artists. And while we support the copyright infringement lawsuits filed by the record industry, the lawsuits should not be used to destroy a viable and useful independent Internet distribution system. It is in the best interests of recording artists, as well as consumers, that Congress promotes an atmosphere of independent digital distribution of music. The solution resides in the marketplace and not in the courtroom. If, however, a resolution cannot be reached quickly, compulsory licenses should be considered, but only as a last resort.

Under the Digital Millennium Copyright Act, performers—that is, recording artists—are now, for the first time ever, entitled to a public performance right. Writers of music share a public performance right with publishers. The publishers do not recoup advances under the writer's share. The writer's share is protected by an independent collection society. Payment for digital performances should follow this logic. It is vitally important that the recording artists receive digital performance royalties directly from the source without the record company recouping royalties against outstanding accounts, or by engaging in unnecessary bureaucratic disputes.

So long as the major record companies represented by the RIAA and the recording artists engage in public battles over these issues, as well as others, the RIAA cannot act as an objective, independent body.

This single, digital, public performance royalty that I speak of is currently in force, and it applies to very specific, non-interactive digital broadcasts only. Recording Artists Coalition believes that Congress should examine the possibility of expanding artist performance rights to include interactive services. Music fans should be able to hear music anywhere, anytime, on demand. Many businesses have recognized that, in the wake of Napster, the competition is for interactivity. The record labels themselves have begun to develop interactive music services as well as license their catalogues to other companies. My colleagues and I are concerned that artists do not have rights to direct remuneration for interactive

services. Furthermore, Congress should ensure that radio stations are not exempt from payment of digital royalties for Internet radio broadcasts. It is fundamentally unfair that broadcasters have always been exempt from paying performers a performance right for analog broadcasting, and we don't want to see this inequity extended to the Internet.

In addition to Internet issues, recording artists have other serious contractual problems with major labels. A new artist agreement is one-sided in favor of the labels. In most cases, a new artist has little leverage for negotiate favorable terms. Many artists and music attorneys believe that the standard industry contract is unconscionable.

The record company in many instances advances all or part of the costs of recording, promotion, and marketing, and then recoups the costs from the artist royalty. As a result, a typical artist could sell half a million records and not see one dollar in royalties. Even if an artist is lucky enough to recoup, the label maintains ownership of the masters and the copyrights. Just as you have so insightfully observed, Mr. Chairman, it is as though you have paid off your mortgage and the bank still owns your house. One way to even this playing field would be for Congress to consider a Federal 7-year term, much like the law that helped movie actors gain free agency in California. While the California law is not perfect, it provides a good model for Congress to consider.

I would like to address just one more important issue, if I might. While there are many ways that Congress can help the recording artist while encouraging a prosperous digital marketplace, expanding fair use is not one of them. Fair use is a delicate balance that adequately addresses the needs of the record companies, the recording artists, and the public.

No recording artist wants to limit the use of his or her music within the traditional parameters of fair use. However, by expanding the exception, Congress will effectively institutionalize free commercial distribution of music on the Internet. This is not why fair use was created. The answer for all parties involved and the public's demand for high-quality digital services lies in the fair licensing of music.

I thank you again for this opportunity to discuss these important issues with the Committee. Congress must continue to hear from the independent voice of recording artists, and the Recording Artists Coalition is dedicated to bringing these and other issues directly affecting us to your attention and to the attention of the public, as well as working with you to resolve these problems. Recording artists must always have an independent voice as our interests are unique and vital and, at times, contrary to the interests of the RIAA and the major record companies. The bottom line is that artists create the music that fuels these industries and, hence, it would appear obvious that our interests and concerns should be seriously considered.

Thank you, sir.

[The prepared statement of Mr. Henley follows:]

STATEMENT OF DON HENLEY, ON BEHALF OF THE RECORDING ARTISTS COALITION
Mr. Chairman and Members of the Committee,

I am honored to be here and I thank you for the opportunity to speak today on behalf of recording artists and the Recording Artists Coalition (RAC). Recording artists have for far too long been insufficiently represented in Washington DC. The RIAA does not speak on behalf of recording artists, even though it gives the impression at times that it does. The RIAA speaks only on behalf of its membership, which is solely composed of major and independent record companies. Over the next several years, the Congress, the Copyright Office, the record companies and the Internet companies will lay the groundwork for intellectual property rules and royalty rates for the exploitation of music on the Internet. At this point, there has been little input from the recording artist community. Most, if not all, of the discussions have been between the labels and the Internet companies. Yet, the artists are the ones who create the content for distribution. There would be no need for these discussions if it were not for artists and we must be actively involved in the development of the framework, or our interests will not be protected. Artists are simply asking for a seat at the table.

As you know Mr. Chairman, RAC was at the forefront of the initiative to repeal the “work for hire” legislation that was enacted in November 1999. I would like to thank you and all the other Senators on the Committee for repealing that legislation. In the past, Copyright Law amendments have been enacted only after serious, and at times, lengthy deliberations. Generally, all interested parties were afforded an opportunity to present their views to Congress. No Copyright Law amendment has ever passed without this type of fair and democratic deliberation, except this most recent amendment.

Before passage of the amendment adding “sound recordings” to the list of works eligible for “work for hire” status, Congress heard only one viewpoint, that of the RIAA. You were told that the amendment was a technical change, when in fact it was a substantive change; one that would have deprived recording artists of the right to pass to their families and heirs the lifeblood of their careers, their sound recording copyrights. Once you recognized this surreptitious manipulation, you set out to right the wrong, and recording artists and their families will never forget your courageous and principled stand.

We are here today to discuss the digital music marketplace and what action, if any, Congress must take to meet the needs of the creators and the consumers. RAC’s position is very simple. We believe that recording artists should always be paid for the exploitation of their sound recordings on the Internet, unless the recording artist makes the decision to provide his or her sound recordings free of charge to listeners.

Napster has stated in public that it intends to build a fee-based service that compensates creators. We look forward to the implementation of that service, and services like it. We recognize that, whether we like it or not, Napster has changed everything. We are listening to our fans. Millions of people have begun to experience interactive music services. They have so far been getting these services free of charge, but I agree with Napster that, with some improvements, many of its users will be willing to pay for this sort of service.

Napster and other “locker” systems have flourished because the record industry has failed to be forward thinking and has made it extremely difficult for legitimate companies to license the rights on an arm’s length basis. The record industry fiddled on the sidelines while the digital revolution went on without them. The major labels should have spent their time negotiating and implementing a fair and comprehensive licensing system; one that addresses the interests of all the parties, including recording artists. While we support the copyright infringement lawsuits filed by the record industry, the lawsuits should not be used to destroy a viable and useful independent Internet distribution system. It is in the best interests of recording artists, as well as consumers, that Congress promotes an atmosphere of independent digital distribution of music. The solution resides in the marketplace and not in the courtroom. If, however, a resolution can not be reached quickly, compulsory licenses should be considered—but only as a last resort.

Under the Digital Millennium Copyright Act (DMCA), performers—that is, recording artists, are now, for the first time ever, entitled to a public performance right. Writers of music share a public performance right with publishers. The publishers do not recoup advances against the writer’s share, as it (the writer’s share) is protected by an independent collection society. Payment for digital performances should follow this logic. It is vitally important that the recording artists receive digital performance royalties directly from the source without the record company recouping royalties against outstanding accounts, or by engaging in unnecessary bureaucratic disputes.

So long as the major record companies, represented by the RIAA, and the recording artists engage in public battles over these issues, as well as others, the RIAA can not act as an objective, independent body.

This single, digital, public performance royalty that is currently in force applies to very specific, non-interactive digital broadcasts only. RAC believes that Congress should examine the possibility of expanding artist performance rights to include interactive services. Music fans should be able to hear music anywhere, anytime, on demand. Many businesses have recognized that, in the wake of Napster, the competition is for interactivity. The record labels themselves have begun to develop interactive music services as well as license their catalogs to other companies. My colleagues and I are concerned that artists do not have rights to direct remuneration for interactive services. Furthermore, Congress should ensure that radio stations are not exempt from payment of digital royalties for Internet radio broadcasts. It is fundamentally unfair that broadcasters have always been exempt from paying performers a performance right for analog broadcasting; we don't want to see this inequity extended to the Internet.

In addition to Internet issues, recording artists have other serious contractual problems with the major labels. A new artist agreement is one-sided in favor of the labels. In most cases, a new artist has little leverage to negotiate favorable terms. Many artists and music attorneys believe that the "standard industry contract" is unconscionable.

The record company, in many instances, advances all or part of the costs of recording, promotion and marketing, and then recoups the costs from the artist royalty. As a result, a typical artist could sell a half million records and not see one dollar in royalties. Even if an artist is lucky enough to recoup, the label maintains ownership of the masters and the copyrights. Just as you have so insightfully observed, Mr. Chairman, it is as though you have paid off your mortgage and the bank still owns your house. One way to even this playing field would be for Congress to consider a federal seven-year term, much like the law that helped movie actors gain free agency in California. While the California law is not perfect, it provides a good model for Congress to consider.

I would like to address one more important issue. While there are many ways Congress can help the recording artist while encouraging a prosperous digital marketplace, expanding fair use is not one of them. Fair use is a delicate balance the adequately addresses the needs of the record companies, the recording artists, and the public.

No recording artist wants to limit the use of his or her music within the traditional parameters of fair use. However, by expanding the exception, Congress will effectively institutionalize free commercial distribution of music on the Internet. This is not why fair use was created. The answer for all parties involved and the public's demand for high-quality digital services, lies in the fair licensing of the music.

I thank you again for this opportunity to discuss these important issues with the Committee. Congress must continue to hear from the independent voice of recording artists. RAC is dedicated to bringing these and other issues directly affecting recording artists to your attention and to the attention of the public, as well as working with Congress to resolve these lingering problems. Recording artists must always have an independent voice as our interests are unique, vital, and at times contrary to the interests of the RIAA and the major record companies. The bottom line is that artists create the music that fuels these industries and hence it would appear obvious that our interests and concerns should be seriously considered.

thank you for your time.

Chairman HATCH. Thank you, Mr. Henley. You have given us a lot to think about.

Ms. Morissette?

STATEMENT OF ALANIS MORISSETTE, RECORDING ARTIST

Ms. MORISSETTE. Good morning, and thank you, Chairman Hatch, for inviting me to testify at today's hearings. I would like to start by letting you know how deeply grateful and fortunate I feel for all of the success and opportunities that I have in my life. I feel blessed to be able to share my expressions the way I do and feel privileged to be able to speak on behalf of fellow artists who have encouraged me to do so.

The reality is that for every artist fortunate enough to be in my position, there are thousands of other incredibly gifted artists whose work may never be heard. It is with this in mind that I speak today on behalf of all musical artists who have a passionate desire for a direct voice when it comes time to discuss the issues that control their future, their livelihoods, and their ability to work and create. I believe it is vital for us to be an integral part of the solution-creating process. I invite other artists to join me, and I honor those artists who have already spoken. I now join them in sharing the same vision and goal.

I have come to realize that what we are trying to do is develop a solution that satisfies the concerns of three separate groups. First, and most importantly, there are the people who listen to the music and are in the audience. Second, there are the artists and all the members of the creative community. And, third, there are the record companies and people who have built and who will continue to build businesses that connect the first two. An effective solution, as I see it, can only culminate if each of these groups have their own voice in the solution-creating process.

Music fans have a voice through elected officials, such as you, the Members of Congress. The record companies have always had their voices heard through their lobbying organizations, such as the RIAA. The reason I am here today is to let you know that although these intermediaries claim to represent the creators, and while there certainly have been some alignment of goals at times, our interests are not always the same.

There are an ever increasing number of ways in which those interests conflict, particularly in the digital age. No matter what you may hear from any of these parties, it is artists, and artists alone, who I believe to be truly able to accurately communicate and represent our unique and fundamental point of view. You need look no further for evidence of this than the recent bankruptcy and work-for-hire issues which would have worked against artists and gone by unnoticed if the artistic community had not spoken up.

As an artist, I have one goal: to continue to create and share my creative expressions with as many people and as directly as possible. If the intermediaries can help facilitate that connection, I welcome their involvement. Where they impede that connection, I question it, and I assume I am not alone in that concern.

My only explanation as to the reasons why artists have not spoken up in the past, individually or collectively, as often as they are beginning to now is this: We are an incredibly diverse group of individuals whose energies go into writing, recording, and producing our music, and months, if not years, of touring on the road. As a result of this diversity and the amount of time and energy spent creating and sharing those creations, it has been difficult for us to speak with a unified voice and to decide who the person or persons would be to speak on our behalf. It has, therefore, been easy for others to speak up under the guise of doing so on our behalf.

I also believe that some artists are afraid of tapping into or being portrayed as having tapped into the business-minded part of themselves, believing that it may somehow compromise their artistic integrity, and I understand this, although I ultimately believe it is an act of self-care and that they are honoring their expressions by

allowing themselves to be aware of and concerned about their livelihood.

I also know there has been fear generated in the artistic community of speaking in a way that would throw any negative light on the relationship between artists and their record companies. I choose not to speak specifically about those issues here today, as one quote taken out of context could be subject to misinterpretation and be deeply misrepresentative of my greater view on this issue. History has not been kind to artists who have candidly expressed points of views that differ from those of their record company. To say the least, to have spoken up could potentially have exacerbated an already strained relationship. Artists want to continue to share their music with as many people as they possibly can. Up until recently, their only way of doing this was through traditional means. Without any other true option that would allow them to pursue their goals, they would understandably, if not reticently, accept the status quo.

We have now clearly evolved into a new and exciting digital era in which we are discovering new ways to share our music directly and interactively. Though I cannot speak for every artist, my initial resistance to the new services created online was based on the debate having been framed in terms of piracy. Being labeled as such by the record companies, it understandably sent a ripple effect of panic throughout the artistic community. But what I have since come to realize is that for the majority of artists, this so-called piracy may have actually been working in their favor. Most recording artists never receive royalties past their initial advance due to the financial structure of most record company contracts. From these artists' viewpoint, their music is free since they do not, in the end, receive money from any of the sales. That free Internet distribution allows the artist to aggregate an audience and create a direct relationship with that audience as well as develop a community among the people who love their music. This in turn allows that artist to generate compensation through other outlets, such as touring and merchandise. For the majority of artists, this amounts to making enough money to be in survival mode.

I believe that most artists write and create motivated by the goal of expressing themselves and of sharing their expressions with as many people as possible and view the financial reward as a natural and welcome outcome as opposed to it being their singular motivation.

At this critical juncture in the digital era, there are an infinite number of decisions to be made regarding how music use will be monitored, where the money generated from such use will go, how it will go there, whom it will go through, and how it will ultimately be divided up.

I believe it would be in everyone's best interest to make sure that the creators of music and art are duly compensated for their work and, most importantly, that they will have a direct voice in the process of making these decisions. I also believe that the people and companies who invest a lot of time and money, working very hard to distribute our music with people around the world, are deserving of being compensated for their work as well. By embracing the concept of interactive music online and by finding the best way

we possibly can to make sure that we come up with a system that allows artists to be compensated for such use online, we are fostering a direct, immediate, mutually gratifying, and I think incredibly exciting relationship between artists and the people with whom they are communicating.

In the big picture, it will benefit the exact companies who have resisted it the most. History has proven time and again that a greater variety of formats and distribution opportunities lead to more choices for consumers, increased awareness of the artists and their music, and ultimately a continued and greater reward financially, creatively, and personally for everybody involved.

As with any paradigm shift, there are understandable fears and apprehensions to be addressed, and I believe we can arrive at a place where all three groups can continue to thrive. However, I believe the only way this can happen is if all three groups communicate their own distinct points of view to each other and if we are all open and honest about our true agendas and concerns. I have always believed in the concept of everyone winning or there not being a deal to be made. That remains true to this day, and yet it would be remiss of me not to notice that the longer we wait in the "no deal" holding pattern while trying to figure this out, we run the risk of missing the opportunity to connect directly with people and of driving these forward-thinking distribution outlets created by the Web underground.

We are faced with many difficult and complex questions during this exciting time in music history. I am here to emphasize how important I believe it to be that, as you are considering constructing legislation that will govern the future of digital music distribution, that I, along with all artists, be actively involved in helping to develop what I know can be gratifying solutions for all involved.

Thank you very much for your time.

[The prepared statement of Ms. Morissette follows:]

STATEMENT OF ALANIS MORISSETTE

Good morning. Thank you Chairman Hatch for inviting me to testify at today's hearings. I would like to let you know how deeply grateful and fortunate I feel for all of the success and opportunities that I have in my life. I feel blessed to be able to share my expressions the way I do and feel privileged to be able to speak on behalf of fellow artists who have encouraged me to do so. The reality is that for every artist fortunate enough to be in my position, there are thousands of other incredibly gifted artists whose work may never be heard. It is with this in mind, that I speak today on behalf of all musical artists who have a passionate desire for a direct voice when it comes time to discuss the issues that control their future, their livelihoods and their ability to work and create. I believe it is vital for us to be an integral part of the solution creating process. I invite other artists to join me and I honor those artists who have already spoken. I now join them in sharing the same vision and goal.

I have come to realize that what we are trying to do is develop a solution that satisfies the concerns of three separate groups: First and most importantly there are the people who listen to the music and are in the audience, secondly, there are the artists and all the members of the creative community and thirdly, there are the record companies and people who have built and who will continue to build businesses that connect the first two. An effective solution, as I see it, can only culminate if each of these groups have their own voice in the solution creating process.

Music fans have a voice through elected officials such as yourselves, members of the congress. The record companies have always had their voices heard through their lobbying organizations such as the RIAA. The reason I am here today is to let you know that although these intermediaries claim to represent the creators, and while there certainly have been some alignment of goals at times, our interests are

not always the same. There are an ever-increasing number of ways in which those interests conflict, particularly in the digital age. No matter what you may hear from any of these parties, it is artists and artists alone who I believe to be truly able to accurately communicate and represent our unique and fundamental point of view. You need look no further for evidence of this than the recent bankruptcy and work-for-hire issues, which would have worked against artists and gone by unnoticed if the artistic community had not spoken up.

As an artist, I have one goal: to continue to create and share my creative expressions with as many people and as directly as possible. If the intermediaries can help facilitate that connection, I welcome their involvement. Where they impede that connection, I question it and I assume that I am not alone in this concern.

My only explanation as to the reasons why artists have not spoken up in the past, individually or collectively, as often as they are beginning to now is this: We are an incredibly diverse group of individuals whose energies go into writing, recording and producing our music, and months if not years of touring on the road. As a result of this diversity and the amount of time and energy spent creating and sharing those creations, it has been difficult for us to speak with a unified voice and to decide who the person or persons would be to speak on our behalf. It has therefore been easy for others to speak up under the guise of doing so on our behalf. I also know that there has been fear generated in the artistic community of speaking in a way that would throw any negative light on the relationship between the artists and record companies. I choose not to speak specifically about those issues here today as one quote taken out of context could be subject to misinterpretation and be deeply misrepresentative of my greater view on this issue. History has not been kind to artists who have candidly expressed points of view that differ with those of their record company. To say the least, to have spoken up could potentially have exacerbated an already strained relationship. Artists want to continue to share their music with as many people as they possibly can. Up until recently, their only way of doing this was through traditional means. Without any other true option that would allow them to pursue their goals, they would understandably, if not reticently accept the status quo.

We have now clearly evolved into a new and exciting digital era in which we are discovering new ways to share our music directly and interactively. Though I cannot speak for every artist, my initial resistance to the new services created online was based on the debate having been framed in terms of "piracy". Being labeled as such by the record companies, it understandably sent a ripple effect of panic throughout the artistic community. But what I have since come to realize is that for the majority of artists, this so-called "piracy" may have actually been working in their favor. Most recording artists never receive royalties past their initial advance due to the financial structure of most record company contracts. From these artists' viewpoint, their music is free since they do not, in the end, receive money from any of the sales. That "free" internet distribution allows the artist to aggregate an audience and create a direct relationship with that audience as well as develop a community among the people who love their music. This in turn allows that artist to generate compensation through other outlets such as touring and merchandise. For the majority of artists, this amounts to making enough money to be in survival mode.

I believe that most artists write and create motivated by the goal of sharing their music with as many people as possible and view the financial reward as a natural and welcome outcome as opposed to it being their singular motivation.

At this critical juncture in the digital era, there are an infinite number of decisions to be made regarding how music use will be monitored, where the money generated from such use will go, how it will go there, whom it will go through, and how it will ultimately be divided up.

I believe it would be in everyone's best interest to make sure that the creators of music and art are duly compensated for their work and most importantly, that they will have a direct voice in the process of making these decisions. I also believe that the people and companies who invest a lot of time and money, working very hard to distribute our music with people around the world are deserving of being compensated for their work as well. By embracing the concept of interactive music online, and by finding the best way we possibly can to make sure that we come up with a system that allows artists to be compensated for such use online, we are fostering a direct, immediate, mutually gratifying and I think incredibly exciting relationship between artists and the people with they are communicating.

In the big picture, it will benefit the exact companies who have resisted it the most. History has proven time and again that a greater variety of formats and distribution opportunities lead to more choices for consumers, increased awareness of the artists and their music and ultimately a continued and greater reward financially, creatively and personally for everybody involved.

As with any paradigm shift there are understandable fears and apprehensions to be addressed and I believe we can arrive at a place where all three groups can continue to thrive. However, I believe the only way this can happen is if all three groups communicate their own distinct points of view to each other and if we are all open and honest about our true agendas and concerns. I have always believed in the concept of everyone winning or there not being a deal to be made. That remains true to this day and yet it would be remiss of me not to notice that the longer we stay in the "no deal" holding pattern while trying to figure this out, we run the risk of missing the opportunity to connect directly with people and of driving these forward thinking distribution outlets created by the web underground.

We are faced with many difficult and complex questions during this exciting time in music history. I am here to emphasize how important I believe it to be that as you are considering constructing legislation that will govern the future of digital music distribution, that I, along with all artists be actively involved in helping to develop what I know can be gratifying solutions for all involved.

Thank you very much for your time.

Chairman HATCH. Thank you very much. We appreciate having you here.

Mr. Barry, we will turn to you.

STATEMENT OF HANK BARRY, INTERIM CHIEF EXECUTIVE OFFICER, NAPSTER

Mr. BARRY. Thank you, Senator. Thank you for inviting me to appear before you today. I am glad to be here representing the more 60 million people who are part of the Napster community.

As I did the last time I was here, I would like to take a moment to acknowledge Shawn Fanning, who is behind me today. He was 19 the last time we met. He is 20 now, so he is over the hill.

The question before us today is: What does it take to make music on the Internet a fair and profitable business? I think it is going to take an act of Congress, a change to the laws to provide an industry-wide license for the transmission of music over the Internet. The Internet needs a simple and comprehensive solution, similar to the one that allowed radio to succeed. The Internet does not need another decade of litigation.

I have tried for the last 9 months to make a market-based solution. We were able to reach agreement with Bertelsmann on a business model and license terms for the sound recordings and the musical compositions that they control. Yet I can't today report that any other such agreement has been reached with a major label or publisher. We were fortunate to make an agreement with Mr. Gottlieb here.

One obstacle may have been a lack of will, but all the record and publishing companies represented on the panel today now say they want to move forward in this area, and I take them at their word. What, then, is the problem? Licensed music should now be available over the Internet as it is over the radio. I think a large part of the problem is complexity.

If you take this CD by the Holmes Brothers, it is no simple object. There are two separate and distinct copyrighted works embodied in each track on this gospel CD. For each track, there is the owner of the sound recording, the tape that you make in the studio. There is also a separate work, the musical composition, the song, the sheet music, the song the artist sings. By law, each track of the CD is also considered a reproduction of the musical composition, so you are buying two works.

On this single CD, for example, there are 13 sound recordings and eight separate music publishers. And that is pretty typical. Now, if you multiply that times 3,000 record companies in the United States and 25,000 music publishers times 27,000 new CDs made ever year, I think you can see that separate, individual negotiations for license agreements are just not viable. They are not a viable option.

This situation has led to endless private negotiations and litigation. Let me show you sort of a John Madden-style diagram of the state of litigation just among those of us who are on the panel here today. That is just the people who are here today.

So how can this mess be cleaned up? Well, I think this is the center of this issue, and here I find myself in surprising agreement with the perceptive, reasoned analysis by the RIAA. You may know that Vivendi-Universal recently made musical compositions available online without getting the publisher's permission. The RIAA has gone to the Copyright Office after the fact, arguing for a compulsory license for situations like this.

Let me quote to you from the petition that the RIAA made to the Copyright Office. "The music industry is unique among owners and users of copyrighted works in that reproduction and distribution of musical works has been subject to a compulsory license since 1909. The availability of a compulsory license has ensured that necessary rights can be obtained when needed, at a known price, and pursuant to established procedures."

The RIAA then argues that extending the compulsory license to their new digital offers would—and I am now quoting again—"avoid the need for individual negotiations on a scale that is unprecedented in the industry and, thus, facilitate the launch" of these new services.

This is the official position of the RIAA, and I endorse this principle. But I endorse it not just for musical compositions but for sound recordings as well.

Congress has repeatedly used such licenses to advance public policy goals in the context of new and frequently inefficient marketplaces. These industry-wide licenses for defined services, with clear payment structures, have encouraged beneficial new technologies and responded effectively to particular market failures.

Music on the radio works because of what is functionally an industry-wide license. Cable television, satellite television, Web casting—you in the Congress have effectively encouraged new technologies through these types of licensing arrangements in a way that fostered competition and benefited consumers and creators alike.

Copyright, Senator, is a tool of public policy. It does not vindicate a private right. Copyright requires a constant balance between the public's interest in promoting creative expression and the public's interest in having access to these works. This is a balance that has often proven impossible to find without the help of Congress.

Finally, the Napster community says loudly and clearly that we want artists and songwriters to be paid. I think that the license you create should also include a direct Internet rights payment to artists. There is certainly precedent for this, Mr. Henley said, in the so-called writer's share of public performance—that is, radio

and television payments that are collected by ASCAP and BMI. You may know that a portion of these payments goes directly to the songwriter.

Senator, this is a moment of tremendous opportunity. For many years, our Nation and this Committee heard wonderful promises of an emerging Internet music era where people could have convenient access to the entire catalogue of recorded music over the Internet at the touch of a button. Well, as often happens, history arrived ahead of time, and it is a uniquely American story. A young man with no standing, no credentials, no connections, and no plan for placating the powerful, sat down outside Boston and created an entirely new system. I think it is meaningful that within 18 months we are no longer debating whether there should be music on the Internet but, rather, debating the best way to make sure that it continues. More than 60 million people have starred on a new stage in our National love affair with music. All of us are finding new music and music we had forgotten how much we loved.

The question before this Committee is a matter of policy: how to make this new world of Internet music work. The next step should not be shutting it down. The Congress has effectively promoted new technologies in the past while ensuring that creators benefit and are paid. And I believe it is essential that we do so again today.

Thank you.

[The prepared statement of Mr. Barry follows:]

STATEMENT OF HANK BARRY, INTERIM CEO, NAPSTER

Mr. Chairman and members of the Committee, thank you for inviting me to appear before you today. I am happy to be here on behalf of Napster and all the members of the Napster community. As I did last time I was here, I would like to take a moment to acknowledge Shawn Fanning, the founder of Napster, who is sitting behind me today. He was 19 then. He is 20 now—and despite his advanced years, he is not yet over the hill.

I think no one in this room—even those with whom we have disagreed vigorously would contest that accessing music over the Internet is something that tens of millions of people, young and old, love to do. Over half of Napster's users are over 25, and they come from all walks of life. The question before us today—from all of our very different perspectives and responsibilities—is what does it take to make music on the Internet a fair and profitable business.

To realize this goal, I believe it will take an Act of Congress—a change to the laws to provide a compulsory license for the transmission of music over the Internet. And today I will tell you why I strongly believe such a change is necessary, an important step for the Internet, and why it will be good for artists, listeners and businesses.

NEGOTIATION HISTORY

When I last testified before this Committee last July, I did not believe this issue required a legislative solution. I believed that Napster should find a private contractual solution that the rights holders and the people who use Napster could all support. We said “let the marketplace work.”

Since that time the Napster community has continued to grow. We then had 20 million members; we have grown to more than 60 million members today, even as we aggressively comply with the District Court's injunction.

Since people who use Napster buy more music than others and are very willing to pay for music over the Internet, I believed there was a basis for making an agreement with the record and music publishing companies. We built our business model around this idea: that the people using Napster want artists and songwriters to be paid, and that peer-to-peer Internet technology is the most efficient and convenient way ever devised to make music accessible.

I have tried for the last 9 months to make an agreement under which Napster can get a license from the record companies and the music publishers. I believed

that any such agreement would serve as a precedent for other agreements and could serve as the basis for payments by the people using Napster to recording artists and songwriters. We were able to reach agreement with Bertelsmann on a business model for a new service and license terms for the sound recordings and the musical compositions they control. Yet I cannot today report that any other such agreement has been reached with a major label.

Perhaps I should not have been surprised at this result. Although the World Wide Web portion of the Internet has been around for 7 years, and billions of investor dollars have been spent founding and attempting to grow technology companies and consumer companies that would help all of us access music over the Internet, to this date no service has been able to provide a comprehensive offering of music on the Internet that is licensed by the major recording and publishing companies.

For the record companies, the promise of music over the Internet has always been “coming real soon now”. Every time this Committee holds a hearing on these issues, new promises of imminent progress are made. Just last July, Fred Ehrlich from Sony told this Committee “we are in active conversations” with both eMusic and mp3.com. But, once again, these have turned out to be empty statements.

The DMCA was supposed to solve many of these problems. As Chairman Hatch said in the last hearing of this Committee on this issue:

“In short, it was believed that a stable, predictable legal environment would encourage the deployment of business models which would make properly licensed content more widely available. Sadly, this has not yet occurred to any great extent in the music industry, and the DMCA is nearly two years old.”

Look at the facts. Where are the Internet businesses with clear and complete recording and music publishing licenses? There are none. Where are the emerging digital media companies with negotiated agreements with all rightsholders? There are none.

And of course these companies argue that this is Napster’s fault. That argument might be granted some validity if there were even one fully-licensed business with anything approaching a comprehensive consumer offer. But there are none.

We might all well ask—why is this so complicated? Why can’t the record companies and music publishing companies just issue licenses to eMusic, Liquid Audio, Listen.com, Yahoo, MSN and Napster, and everyone else, so consumers can pay money and have access to music over the Internet, while ensuring that artists and songwriters are paid? Why have the record and publishing companies continually said they are going to license, and then not followed through?

Well, one obstacle may have been a lack of will—the record companies have stated repeatedly that they believe that licenses of sales over the Internet will cut into physical goods sales and generally damage, not increase, their business. This fear, of course, has not been founded in reality to date. CD sales are stronger than other retail, even in the face of uncertain economic times. Internet music has increased interest in music as a whole. Like the VCR, the cassette, and every other major innovation, Internet music has been greeted by a chorus of doom from existing distributors. But let’s assume that the will is there to license music over the Internet—certainly all of the record and publishing companies represented on this panel now say they want to move forward in this area.

Even if we assume that everyone agrees that licensing music for the Internet would be a good thing, my experience is that it is an almost impossibly complicated thing. And unfortunately I have to explain how complicated it is by going over the rights structure in this industry. So if you will let me do that. . .

INDUSTRY OVERVIEW

This background description here is for those of you who are not copyright lawyers. Bob Kohn of eMusic wrote a great book on this if you want further information.

As the members of this Committee know, when you buy a CD or tape, you are really getting copies of two separate works. The first is the sound recording that the artist and producers and musicians made in the studio. The second is the musical composition, the song that is being played. By law, each copy of the CD is also considered a reproduction of that musical composition. The complex part about this is that the sound recording and the musical composition that is sung on the sound recording (the “song”—the music) are almost always owned by different companies, even where, as in many cases, the recording artist is the same person who wrote the song.

Now if you are trying to make music available to the public on the Internet, whether for download or streaming or even for broadcast, and if you need a private contractual agreement to do that, then you have to negotiate with both sets of

rightsholders—the record companies and the music publishers. First you have to go to the record companies (and if you want the good stuff, like polkas and Lithuanian folk songs, you have to go to many record companies—there are over 3,000 record companies in the US alone).

And when you have negotiated each of those 3,000 separate agreements, you are only half way there—because then you have to go and negotiate with all of the music publishers—and there are over 25,000 independent music publishers in the US alone. Mr. Murphy’s organization represents many of them, but I believe Mr. Roberts from MP3.com would tell you that anything less than an overall comprehensive license to all compositions doesn’t do you much good, because the likelihood is that rights you have and the rights you need will not match at all. And even one failure to match can bring down the whole structure.

This is further complicated by the fact that several of the largest music publishers, controlling millions of songs, are owned by the record labels, but the music publishing catalogs they control bear no relation to the sound recordings they control—they are not the same songs. For a final complication—the music publishers have two separate rights, the right to make a mechanical copy of the song and the public performance right, that may both be implicated in this type of licensing. And each of those rights is administered for them by a different rights organization.

Now, as you know Senator, that is a simplified statement of the rights structures in this industry.

COMPULSORY LICENSES

So, what can Congress do to simplify this in a way that will work?

Well, here—at the center of the matter—I find myself in surprising agreement with a perceptive recent analysis by the RIAA.

Vivendi Universal and the National Association of Music Publishers are in a dispute based on the fact that Universal made musical compositions available online without getting the publishers’ permission. The RIAA has gone to the Copyright Office seeking guidance as to whether Section 115 of the Copyright Act applies in such circumstances. The RIAA articulates a compelling case for the need for compulsory licenses. The RIAA says that two fundamental problems limit access to music on the Internet: first, that independent sequential negotiations with all rights holders (like those I described a minute ago) are practically impossible in any reasonable time frame. Second, they say that the laws regarding rights are unclear.

It’s an argument I would like to examine with you in some detail.

So let me quote now from the RIAA’s Petition. I have attached the entire Petition to my testimony.

The RIAA said: “To the extent that On-Demand streams and Limited Downloads make use of musical works, it is right and proper that songwriters and music publishers receive a reasonable royalty, as appropriate and as provided under existing law. RIAA’s member companies are ready and willing to pay reasonable applicable royalties for the services they operate or authorize.”

[so far so good]

A few paragraphs down, they continue.

“To be compelling to consumers, it is believed that a service must offer tens or hundreds of thousands of songs, in which rights may be owned by hundreds or thousands of publishers. No service provider is eager to embark on individual negotiations with all those publishers unless it is necessary.”

[well—that’s my experience too. Continuing. . .]

“The music industry is unique among owners and users of copyrighted works in that reproduction and distribution of musical works has been subject to a compulsory license since 1909. In the nearly a century that the mechanical compulsory license has existed, it has become the foundation of business practices that are deeply ingrained in the industry and have been embraced by the copyright owners whose works are subject to it.”

“ . . . the availability of a compulsory license has ensured that necessary rights can be obtained, when needed, at a known price, and pursuant to established procedures. Recognizing that the business practices founded upon the compulsory license extend to On-Demand streams would avoid the need for individual negotiations on a scale that is unprecedented in the industry and thus facilitate the launch of On-Demand Streaming services. . . ”

“The lack of clarity as to the issues described above has become the primary obstacle to the launch of digital services designed to meet ever-increasing consumer demand Representatives of the RIAA and its members have negotiated with representatives of music publishers concerning the licensing of services that would offer On Demand Streams and Limited Downloads. However, in large part because

of the uncertainty as to the fundamental questions of law addressed above, these negotiations have not yet successfully resolved the matter.”

In short, the RIAA’s position is that Internet music is a mess because everyone involved asserts complex and varying rights, that there are too many potential licensors for “independent sequential negotiations”, and that the best way for the market to move forward quickly and fairly may be a compulsory license for musical compositions.

That is the official position of the RIAA—and I endorse this principle. But I endorse it not just for musical compositions -but for sound recordings as well. Not just for music publishers, but also for record companies.

DO THEY WORK? EXAMPLES OF COMPULSORY LICENSES

As the RIAA says, compulsory licenses have a long history of success, allowing for the widespread implementation of a new technology while ensuring that rights holders are compensated. Congress has repeatedly used such licenses as a way of advancing public policy goals in the context of new and frequently inefficient marketplaces. Compulsory licenses have encouraged beneficial new technologies, and responded effectively to particular market failures—including excessive contracting costs and anticompetitive market structures.

Let’s look at some examples:

In 1909, Congress created a right against the reproduction of musical compositions in mechanical forms (i.e., piano rolls), but limited this right through the creation of a mechanical compulsory license for musical works. The legislative history behind the mechanical compulsory license reveals that Congress enacted this provision, not only to compensate composers, but to prevent the Aeolian Company, which had acquired mechanical reproduction rights from all of the nation’s leading music publishers, from limiting the dissemination of the music to the public through the creation of a monopolistic environment. Thanks to this, once a song has been recorded by anybody, it may be recorded by anyone else, without a further license from the music publisher, if the person making the new recording notifies the publisher and pays a statutorily mandated royalty based on the number of copies made. That’s where “cover” songs come from—and only those of us who have heard different versions of “Louie Louie” can appreciate what that compulsory license has meant for American music.

Years later, Congress again enacted several additional compulsory license, this time related to consumers’ ability to access broadcast transmissions via cable and satellite systems. In 1976, Congress passed a compulsory license for cable television systems that retransmit copyrighted works. Pursuant to the compulsory license provision, copyright owners are entitled to be paid prescribed royalty fees for a cable television company’s secondary transmission of the copyrighted work embodied in television and radio broadcasts.

Then, in 1988, Congress passed the Satellite Home Viewer Act of 1988 (SHVA), which created a compulsory license system for satellite carriers that retransmit television broadcasts that operates similar to the cable compulsory license. Congress acted again in 1999 when it expanded the SHVA’s scope to include local-into-local retransmission.

Congress recognized the ability of these then cutting edge technologies to further disseminate to the public television and radio content, and the need to ensure that rights holders remained adequately compensated. Congress understood, however, the inefficiencies inherent in forcing cable or satellite providers to negotiate individual licensing agreements, thereby resulting in the use of a compulsory license system.

Interestingly enough, considering the current controversy, Congress’ next foray into compulsory licenses applied specifically to music. The Digital Performance Rights in Sound Recordings Act of 1995 created a limited performance right for sound recordings, subject to a compulsory license for certain digital audio deliveries of sound recordings. The compulsory license originally applied, in general, to non-interactive satellite and cable audio digital deliveries. The Digital Millennium Copyright Act amended the original law to explicitly include non-interactive webcasting of sound recordings within the compulsory license’s scope.

At the time, Congress reasoned that these new technologies promised to encourage the widespread dissemination of this music to the public. Once again, Congress enacted the compulsory license mechanism as a means to ensure that artists and other rights holders were compensated, while not hindering the continued development and deployment of these digital delivery systems.

Finally, I think we can all agree that AM and FM radio have been good for recorded music. The benefits of radio have flowed from the effective compulsory li-

cense created by performing rights societies, such as ASCAP and BMI. They enforce songwriters' and music publishers' performance rights through a court created process that removes the need to negotiate with individual rights holders. While Congress did not create this procedure, it has implicitly endorsed it by recognizing these performing rights societies in recent legislation. Further, Congress repeatedly has refused requests to outlaw the use of these blanket licenses.

In all of these cases of compulsory licensing, creators benefit from, but do not completely control, the distribution of their product. A balance is struck—a balance that is at the heart of all intellectual property law. Remember, intellectual property is not the same as real property or personal property—copyright is a limited right. Copyright is not based on a private right of the individual, it is a creation of and a tool of public policy. It requires a constant balance between the public's interest in promoting creative expression and the public's interest having access to those works. This is a balance that has often proven impossible to find without the help of the Congress.

IMPORTANT ELEMENTS OF ANY LICENSING REGIME FOR INTERNET MUSIC

Let me offer a few specific elements that I think are important for a fair and equitable compulsory license law.

Any such solution has to apply to the entire catalog of the applicable rightsoowner, whether record company or music publisher. Too often companies have entered into licensing arrangements that contain a clause saying that the subject matter of the license will be decided "later, when the rightsholders can determine what rights the rightsholder owns and can license." This process, which is generally know a "rights clearances" is often used to transform what looks like a real license into an empty shell.

Any such solution should also offer licensees both the sound recording rights and the musical composition rights. As we have seen above, it makes no sense for a licensee to have a sound recording license, and then have to begin negotiating with all the publishers.

Any technology requirements for copyright management and security have to be general enough so that they are capable of being fulfilled by many vendors. Private licensing regimes have been recently reported which would violate this basic principle of neutrality, by linking access to rights to the use of particular software—even as there are interlocking financial arrangements between the rightsholders and the software companies. ASCAP cannot tell a radio station what brand of transmitter to use; and no such new technological extensions of market power should be a part of any new licensing.

The licensing terms under any compulsory licensing system must be the same for all. I am particularly concerned here about a point Senator Hatch made at our hearing last July, that he was concerned that the major record companies would make cross-licensing arrangements among each other that would have economic terms that would ensure that the Internet services the record companies operate would have greater profits than any other licensed services.

BENEFITS TO ALL ARTISTS

We must be careful to construct a structure that will allow all recording artists, songwriters, record companies and publishers, not just the few large entities, to participate and profit from music on the Internet. I believe that the great strength of American music is as much in choral, gospel and inspirational music bands, as it is in the latest Top 40 hits. Certainly a 10 minute walk through the shared files of Napster users suggests the same. We all listen to everything. And so all independent labels and publishers should participate as well.

Finally, I think we should adopt a direct Internet rights payment to artists. There is certainly precedent for this in the so-called "writer's share" of public performance (radio and television) payments that are made by ASCAP and BMI. As you know, a portion of those payments goes directly to the songwriter. We can do the same and give artists a direct benefit from these new technologies.

CONCLUSION

Senator, this is a moment of tremendous opportunity. For many years, our nation and this Committee heard wonderful promises of an emerging digital music era, where people could have convenient access to the entire catalog of recorded music over the Internet at the touch of a button.

Well, as often happens, history arrived ahead of time.
And it is a uniquely American story.

A young man with no standing, no credentials, no connections, and no plan for placating the powerful, sat down outside Boston and created an entirely new system.

Within 18 months, we were no longer debating whether there would be music on the Internet, but debating the best way to make sure that it continues. More than 60 million users have started a new stage in our national love affair with music. Napster users are nearly 50% more likely to say they are listening to more music now than six months ago, compared to others on line. All of us are finding new music—and music we'd forgotten how much we loved.

The question before this Committee is a matter of policy. How to make this new world of Internet music work. The next step should not be shutting it down, but making it work for everyone. The Congress has effectively promoted new technologies in the past, while ensuring that creators benefit; it is essential that we do so again today.

Thank you.

Before the
COPYRIGHT OFFICE
LIBRARY OF CONGRESS
Washington, D.C.

_____)	
In the Matter of)	
)	
Application of the Mechanical Compulsory)	Docket No. _____
License to Certain Digital Music Services)	
)	
_____)	

**PETITION FOR RULEMAKING AND TO CONVENE COPYRIGHT
ARBITRATION ROYALTY PANEL IF NECESSARY**

There is a pressing need in the marketplace for legitimate digital music services, driven by the dual forces of exploding consumer demand and a proliferation of digital music services that are infringing copyrighted musical works and sound recordings. To meet this demand, record companies and third parties they have authorized to use their recordings (“Third Party Services”) are aggressively preparing to launch new digital music services.

Two music delivery technologies attractive to consumers are “On-Demand Streams” and “Limited Downloads.” For purposes of this petition, we use the term “On-Demand Stream” to refer to an on-demand, real-time transmission using streaming technology such as Real Audio, which permits users to listen to the music they want when they want and as it is transmitted to them. We use the term “Limited Download” to refer to an on-demand transmission of a time-limited or other use-limited (*i.e.* non-permanent) download to a local storage device (*e.g.* the hard drive of the user’s computer), using technology that causes the downloaded file to be available for listening only either during a limited time (*e.g.* a time certain or a time tied to ongoing subscription payments) or for a limited number of times.

Record companies are ready and willing to pay any necessary royalties to musical work copyright owners when record companies use or authorize the use of musical works in services that transmit On-Demand Streams and/or Limited Downloads. In doing so, they expect to rely, to the extent they can, upon the mechanical compulsory license in Section 115 of the Copyright Act and licensing procedures that have been agreed upon with The Harry Fox Agency, Inc. (“HFA”), the leading mechanical licensing agency.

Representatives of the Recording Industry Association of America, Inc. (“RIAA”) and its members have negotiated with HFA and other representatives of music publishers concerning the licensing of services that would offer On-Demand Streams and Limited Downloads. However, those negotiations have not yet successfully resolved the matter, in large part because of uncertainty as to fundamental questions of law addressed in this petition. Among other things, representatives of music publishers have taken the position that both On-Demand Streams and Limited Downloads implicate their mechanical rights.¹

Treatment of On-Demand Streams as incidental digital phonorecord deliveries² (“Incidental DPDs”) would facilitate the launch of services that make On-Demand Streams, but there remain questions about whether this treatment is appropriate. Determination of a statutory royalty rate for Incidental DPDs has been deferred, *see* 37 C.F.R. § 255.6, so if this treatment is proper, it is imperative that a royalty rate for Incidental DPDs be determined promptly.

¹ To our knowledge, publishers have not taken the position that streams other than On-Demand Streams (e.g. webcasts) implicate their mechanical rights.

² *I.e.*, digital phonorecord deliveries (“DPDs”) where the reproduction or distribution of a phonorecord is incidental to the transmission which constitutes the DPD. *See* 17 U.S.C. § 115(d).

Limited Downloads would more clearly seem to implicate publishers' mechanical rights, but the applicable royalty is unsettled. The making of Limited Downloads may constitute distribution by acts or practices in the nature of rental, lease or lending. However, it is also possible that a Limited Download is an Incidental DPD. If the former, Section 115(c)(4) of the Copyright Act provides a formula for determining the applicable royalty, but the Register of Copyrights has not issued the regulations contemplated by that provision that are necessary to carry out its purpose. If the latter, there is, as noted above, no applicable statutory royalty rate.

In any event, in addressing the application of the mechanical compulsory license to On-Demand Streams and Limited Downloads, the Copyright Office should make clear that the compulsory license extends to all the activities necessary to transmit On-Demand Streams and Limited Downloads.

Because record companies and/or Third Party Services are willing and able to launch legitimate digital music services that will meet the enormous consumer demand for such services, the lack of clarity as to these issues has become the primary obstacle to their launch. The time has come to resolve these issues. Accordingly, RIAA respectfully requests that the Copyright Office (1) commence a rulemaking pursuant to 17 U.S.C. § 702 to address the application of the mechanical compulsory license to On-Demand Streaming and Limited Downloads; (2) if it is determined that either On-Demand Streaming or Limited Downloads constitute the making and distribution of Incidental DPDs, then, pursuant to 17 U.S.C. §§ 115(c)(3)(D), 801(b)(1), 803(a)(1), (3), and 37 C.F.R. §§ 251.61(a)(4), 255.6, convene a Copyright Arbitration Royalty Panel ("CARP") to determine the applicable royalty rates and terms for the period beginning January 1, 1998 and ending on December 31, 2002; and (3) if

it is determined that Limited Downloads constitute distribution by acts or practices in the nature of rental, lease or lending, issue the regulations contemplated by Section 115(c)(4).

BACKGROUND

RIAA is the trade association that represents the U.S. recording industry. Its mission is to foster a business and legal climate that supports and promotes its members' creative and financial vitality. Its members are the record companies that comprise the most vibrant national music industry in the world. RIAA members create, manufacture and/or distribute approximately 90% of all legitimate sound recordings produced and sold in the United States.

It is well known that consumers want to listen to and obtain music online. The recording industry is acutely aware of this desire and understands the benefits to artists, record companies, songwriters, music publishers and consumers alike of electronic delivery of music. The industry is excited about, and eagerly embracing, the opportunities for such delivery offered by the Internet. The success of the recording industry always has depended upon bringing consumers the music they love, and the recording business is all about finding new ways to make music available to more people. Thus, for decades, the industry has been an innovator of means to combine new technology with the creative process to deliver music in new ways.

Services that will transmit On-Demand Streams and/or Limited Downloads are currently under development by record companies and Third Party Services, and in some cases ready for imminent launch. For example, Unsurface, which will be unveiled first quarter 2001, will allow users to access music and other content from a digital storage locker, where it will be available for On-Demand Streaming. *See Bruce Haring, In a First, Sony Prepares for Launch of Multimedia 'Jukebox' for Digital Content, Inside (Oct. 5, 2000)*

available at http://www.inside.com/story/Story_Cached/0,2770,10639_9_16_1,00.html.

Universal Music Group also is beta testing a service. See *Universal Offers Test of Subscription Plan*, DigitalMusicWeekly.com (Oct. 27, 2000) available at <http://www.digitalmusicweekly.com/issues/dmw10272000.html#Headline310>. Others that have announced their intention to launch services that will transmit On-Demand Streams and/or Limited Downloads include Emusic.com, Inc., MP3.com, Inc. musicbank, Incorporated and Streamwaves.com, Inc.

Some services may make On-Demand Streams and Limited Downloads available on a peer-to-peer basis. Some may make them available on a subscription basis, while others may rely upon other revenue sources. However, while there may be variations in the business models of services that offer On-Demand Streams and Limited Downloads, these modes of music delivery themselves are straightforward, and the fundamental legal questions concerning the application of Section 115 to these technologies can be resolved irrespective of any variations in the businesses in which these technologies may be used.

DISCUSSION

I. The Application of Section 115 to On-Demand Streams and Limited Downloads Has Not Been Resolved and the Applicable Rate is Unsettled

RIAA believes that it should be possible to launch services that make On-Demand Streams and Limited Downloads under the existing statutory framework while respecting the copyright protection that ensures the continuation of the creative process. However, record companies take very seriously their obligations under copyright law, and it is simply not clear what licenses are required to operate these services. This ambiguity is of grave concern to record companies and Third Party Services that are poised to launch services. To the extent that On-Demand Streams and Limited Downloads make use of musical works, it is right and

proper that songwriters and music publishers receive a reasonable royalty, as appropriate and as provided under existing law. RIAA's member companies are ready and willing to pay reasonable applicable royalties for the services they operate or authorize.

The mechanical compulsory license of Section 115(a)(1) of the Copyright Act provides that when phonorecords of a nondramatic musical work have been distributed to the public in the U.S., anyone may obtain a compulsory license to make and distribute phonorecords of the work, including by DPD and by acts or practices in the nature of rental, lease or lending. *See* 17 U.S.C. §§ 115(a)(1), (c)(4). It is not clear, however, whether Section 115 authorizes the full range of activities necessary to make On-Demand Streams or Limited Downloads, and if it does, it is not clear what royalty applies. Thus, to provide the ground rules for services providing On-Demand Streams and Limited Downloads, it is necessary (1) to resolve whether On-Demand Streams are Incidental DPDs covered by the mechanical compulsory licensing provisions, (2) to confirm that the mechanical compulsory license includes the right to make the server copies or other copies necessary to transmit On-Demand Streams and Limited Downloads, and (3) to determine the royalty rate applicable to On-Demand Streams (if they are covered by the mechanical compulsory license) and Limited Downloads.

A. Recognizing that the Mechanical Compulsory License Authorizes all Activities Necessary for the Transmission of On-Demand Streams would Facilitate the Launch of Services, but There Are Questions about Whether that Treatment Is Appropriate

Representatives of music publishers have taken the position that On-Demand Streams implicate their mechanical rights. Treatment of On-Demand Streams as Incidental DPDs would facilitate the launch of services that make On-Demand Streams. To be compelling to consumers, it is believed that a service must offer tens or hundreds of thousands of songs, in

which rights may be owned by hundreds or thousands of publishers. No service provider is eager to embark on individual negotiations with all those publishers unless it is necessary.

The music industry is unique among owners and users of copyrighted works in that reproduction and distribution of musical works has been subject to a compulsory license since 1909. In the nearly a century that the mechanical compulsory license has existed, it has become the foundation of business practices that are deeply ingrained in the industry and have been embraced by the copyright owners whose works are subject to it. When the Chairman of the House Judiciary Subcommittee on Intellectual Property and Judicial Administration proposed eliminating the compulsory license some years ago, RIAA agreed, but the National Music Publishers Association (“NMPA”) insisted on retaining it. Indeed, it is NMPA that proposed the extension of the compulsory license to DPDs in the Digital Performance Right in Sound Recordings Act of 1995 (“DPRA”).

While record companies historically have invoked the compulsory license only rarely, the availability of a compulsory license has ensured that necessary rights can be obtained, when needed, at a known price, and pursuant to established procedures. Recognizing that the business practices founded upon the compulsory license extend to On-Demand Streams would avoid the need for individual negotiations on a scale that is unprecedented in the industry and thus facilitate the launch of On-Demand Streaming services.

However, there remain questions about whether this treatment is appropriate. A DPD is an “individual *delivery* of a *phonorecord* by digital transmission of a sound recording, which results in a *specifically identifiable reproduction* by or for any transmission recipient of a *phonorecord* of that sound recording” 17 U.S.C. § 115(d) (emphasis added). When an On-Demand Stream is received, small portions of the On-Demand Stream are buffered for a

short time on a revolving basis, but it is not clear that any “specifically identifiable” “phonorecord” ever is reproduced or delivered. Thus, whether On-Demand Streams are Incidental DPDs is unsettled, and the answer to this fundamental question will affect numerous service providers.

B. The Compulsory License Includes the Right to Make All the Copies Necessary to Operate Services

In addressing the application of the mechanical compulsory license to On-Demand Streams and Limited Downloads, the Copyright Office should make clear that the compulsory license extends to all the activities necessary to transmit On-Demand Streams and Limited Downloads. Specifically, in order to make either On-Demand Streams or Limited Downloads, the operator of a service generally must make multiple phonorecords of musical works on its servers, and those works may be further reproduced, at least in part and for periods of short duration, as part of the transmission process. While some of these reproductions may be exempt under Section 112(a), it is likely that certain reproductions necessary for the operation of commercial services are not exempt under Section 112(a). RIAA believes that a mechanical compulsory license must be understood to cover these activities *in toto*. Thus, a mechanical license covering either Limited Downloads or On-Demand Streams (if an On-Demand Stream is an Incidental DPD) must be understood to encompass the reproductions made on the service’s servers and as part of the transmission process, just as a mechanical license for the reproduction and physical distribution of phonorecords always has been understood to encompass the masters and stampers from which are made the physical phonorecords ultimately distributed to the public. A contrary result would render the amendments made to Section 115 by the DPRA a nullity by always allowing

the exclusive rights of the musical work copyright owner to prevent the making and distribution of the DPDs that the Act was intended to authorize.

C. Action Is Necessary to Determine the Applicable Royalty Rate

It is not clear what royalty rate applies to either On-Demand Streams or Limited Downloads. In the case of On-Demand Streams, the issue is the uncertainty described above concerning the application of Section 115 to On-Demand Streams. If it is concluded that On-Demand Streams are Incidental DPDs, Section 115 provides a relevant rate category, but determination of a statutory royalty rate for Incidental DPDs has been deferred, 37 C.F.R. § 255.6.

It simply is not clear how Limited Downloads should be treated for purposes of Section 115. Section 115 and its implementing regulations identify four rate categories that apply to phonorecords made and distributed under the mechanical compulsory license, depending on the nature of the phonorecords made and/or the means by which they are distributed: (1) phonorecords with which the compulsory licensee has voluntarily and permanently parted possession by physical distribution, *see* 17 U.S.C. § 115(c)(2); 37 C.F.R. § 255.3; (2) Incidental DPDs, *see* 17 U.S.C. § 115(c)(3)(C) and (D); 37 C.F.R. § 255.6; (3) DPDs in general (“General DPDs”), *see* 17 U.S.C. § 115(c)(3)(C) and (D); 37 C.F.R. § 255.5; and (4) phonorecords distributed “by rental, lease, or lending (or by acts or practices in the nature of rental, lease, or lending),” 17 U.S.C. § 115(c)(4).

It is clear that transmitting Limited Downloads does not involve the permanent physical distribution of phonorecords (category 1). Since the enactment of the DPRA, General DPDs (category 3) have borne the same rate as physical phonorecords. That result can be justified only on the basis that permanent downloads give consumers the benefits of ownership of a phonorecord. Limited Downloads stand in sharp contrast to the permanent

downloads that clearly constitute General DPDs, so that too would seem to be the wrong rate category. If Limited Downloads are neither physical phonorecords nor General DPDs, it follows that there are only two options: that the transmission of Limited Downloads either constitutes (1) distribution by acts or practices in the nature of rental, lease or lending (because transmitting a Limited Download is the functional equivalent of renting, leasing or lending a phonorecord by means of physical delivery for the same limited period) or (2) the making of Incidental DPDs (because the reproduction or distribution of a phonorecord for a limited time is incidental to the limited number of listens that are permitted).

In either case, action by the Copyright Office is required. If the Incidental DPD rate applies, determination of a statutory royalty rate has been deferred, 37 CFR § 255.6. If the rental rate applies, Section 115(c)(4) of the Copyright Act provides a formula for determining the applicable royalty, but the details of calculating the royalty are unclear, and the Register of Copyrights has not issued the regulations contemplated by that provision that are necessary to carry out its purpose. Action by the Copyright Office is, therefore, imperative so that RIAA's members and Third Party Services can meet the marketplace demand for On-Demand Streams and Limited Downloads by offering the public legitimate access to recorded music. In the meantime, RIAA members may elect to obtain compulsory licenses or licenses through agreed-upon licensing procedures, and they are committed to pay applicable royalties (including on a retroactive basis as determined), and maintain records sufficient to ensure that proper payments are made upon determination of such royalties.

II. The Application of Section 115 to Digital Music Services Is Ripe for Determination

A. There Is a Compelling Need to Resolve the Application of Section 115 to On-Demand Streams and Limited Downloads

The lack of clarity as to the issues described above has become the primary obstacle to the launch of digital services designed to meet ever-increasing consumer demand. Thus, a determination by the Copyright Office with respect to the application of Section 115 to On-Demand Streams and Limited Downloads, and a determination of the relevant rate(s), is essential.

Representatives of RIAA and its members have negotiated with representatives of music publishers concerning the licensing of services that would offer On-Demand Streams and Limited Downloads. However, in large part because of uncertainty as to the fundamental questions of law addressed above, those negotiations have not yet successfully resolved the matter. These questions affect even the structure of such negotiations. If the mechanical compulsory license is available to cover *in toto* services offering On-Demand Streams and Limited Downloads, then voluntary mechanical licenses can be offered by HFA, and it is appropriate that royalty rates be negotiated on an industry basis by RIAA and HFA as has been the case for decades. If, however, the mechanical compulsory license does not cover *in toto* services offering On-Demand Streams and Limited Downloads, then it is necessary that thousands of individual publishers make individual decisions about whether, and on what terms, to license their songs. It would be very burdensome for those seeking to launch

services to negotiate licenses with thousands of individual publishers, but it is important that these issues be resolved promptly so that such negotiations can begin if necessary.³

Moreover, the current uncertainty surrounding the applicable royalty rate presents a serious risk to those seeking to create a legitimate business. Although the compulsory license permits the launch of services offering On-Demand Streams and Limited Downloads without infringement liability for the activities covered by the license, the risk associated with an uncertain royalty rate remains substantial.

Record companies are excited at the prospect of consumers having access to On-Demand Streams and Limited Downloads and are committed to operating or authorizing such services in compliance with copyright law. The record companies that elect to obtain compulsory licenses are committed to pay applicable royalties once determined and maintain records sufficient to ensure that proper payments are made upon determination of such royalties.

B. The Copyright Office is the Proper Forum to Resolve the Application of Section 115 to On-Demand Streams and Limited Downloads

Section 702 of the Copyright Act authorizes the Copyright Office “to establish regulations not inconsistent with law for the administration of the functions and duties made the responsibility of the Register under this title.” As the Copyright Office has recognized, Section 702 “makes it plain that the Copyright Office is vested with authority to interpret provisions of the Act . . .” *Cable Compulsory License; Definition of Cable System*, 57 Fed.

³ Reliance upon the mechanical compulsory license is burdensome as well, and it would be desirable for any rulemaking or CARP undertaken pursuant to this petition to consider streamlining compulsory license procedures to the extent consistent with law.

Reg. 3284, 3290 (Jan. 29, 1992) (*citing* 17 U.S.C. § 702); *see also id.* at 3292 (“[T]he Office is charged with the duty to interpret the statute in accordance with Congress’ intentions and framework and, where Congress is silent, to provide reasonable and permissible interpretations of the statute”).

The Copyright Office has frequently exercised its authority to interpret provisions in the Copyright Act relating to statutory licenses, and its decisions to do so have been affirmed by the courts. *See, e.g., Satellite Broad. and Communications Ass’n v. Oman*, 17 F.3d 344, 347 (11th Cir. 1994) (“The Copyright Office is a federal agency with authority to promulgate rules concerning the meaning and applicability of” statutory license provisions) (*citing Cablevision Sys. Dev. Co. v. MPAA, Inc.*, 836 F.2d 599, 608-9 (D.C. Cir. 1988)). The Copyright Office recently reaffirmed this authority. *See Satellite Carrier Compulsory License; Definition of Unserved Household*, 63 Fed. Reg. 3685 (Jan. 26, 1998).

The application of Section 115 to On-Demand Streams and Limited Downloads is particularly apt for a rulemaking proceeding, where all interested parties can file comments on the issue and a rule can be issued after consideration of these comments. *Cf. Kappelmann v. Delta Air Lines, Inc.*, 539 F.2d 165, 171 (D.C. Cir. 1976) (decisions “involv[ing] both technical and policy questions which have industry-wide application ... are better made on an industry-wide basis in an agency rulemaking proceeding.”) (citations omitted). Because this case does not involve the legal rights of only two individual parties, but implicates the interests of multiple industry groups and thousands of companies, it is not suitable for resolution, in the first instance, by the courts. Indeed, absent a clear rule from the Copyright Office, various parties could end up engaging in multiple lawsuits in different forums throughout the country, since no single district court may be able to render an interpretation of

the Act, and to enter a judgment, that would bind all of the hundreds of record companies, thousands of music publishers and many others affected by Section 115's application to On-Demand Streams and Limited Downloads.

While, as described above, it may well be necessary to convene a CARP to determine a mechanical royalty rate for Incidental DPDs, the full range of issues described in this Petition cannot and should not be resolved by CARP. A CARP has authority only "[t]o make determinations *concerning the adjustment of reasonable copyright royalty payments*" as provided in various statutory licenses, including Section 115. 17 U.S.C. § 801(b)(1) (emphasis added). Section 115 provides that the Librarian of Congress shall convene a CARP "to determine *a schedule of rates and terms. . . .*" 17 U.S.C. § 115(c)(3)(D) (emphasis added). Nothing in the Copyright Act authorizes a CARP to address the application of a compulsory license to a particular type of service.

Entrusting this issue of statutory interpretation to a CARP also makes little practical sense. It is the Copyright Office and not the CARP that has the relevant expertise to interpret the Copyright Act. The Copyright Office should not be relegated to reviewing CARP interpretations of the Copyright Act pursuant to the deferential standard in Section 802(f). It is the CARP that should defer to the Copyright Office's interpretations and not *vice versa*. See *SBCA v. Oman, supra*, 17 F.3d at 347 ("Copyright Office's interpretation of the Copyright Act should ordinarily receive deference") (citing *DeSylva v. Ballentine*, 351 U.S. 570, 577-78 (1956)).

CONCLUSION

For the foregoing reasons, RIAA respectfully requests that the Copyright Office (1) commence a rulemaking pursuant to 17 U.S.C. § 702 to address the application of the mechanical compulsory license to On-Demand Streaming and Limited Downloads; (2) if it is determined that either On-Demand Streaming or Limited Downloads constitute the making and distribution of Incidental DPDs, then, pursuant to 17 U.S.C. §§ 115(c)(3)(D), 801(b)(1), 803(a)(1), (3), and 37 C.F.R. §§ 251.61(a)(4), 255.6, convene a Copyright Arbitration Royalty Panel (“CARP”) to determine the applicable royalty rates and terms for the period beginning January 1, 1998 and ending on December 31, 2002; and (3) if it is determined that Limited Downloads constitute distribution by acts or practices in the nature of rental, lease or lending, issue the regulations contemplated by Section 115(c)(4).

November 22, 2000

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Chairman HATCH. Thank you, Mr. Barry.
Mr. Gottlieb, we look forward to your testimony.

**STATEMENT OF STEVE GOTTLIEB, PRESIDENT AND FOUNDER,
TVT RECORDS**

Mr. GOTTLIEB. Mr. Chairman and distinguished members of the Committee, good morning, and thank you for inviting me to participate. I am both honored and humbled to be here among such highly celebrated business colleagues and legendary recording artists. My purpose in appearing before you today is to share our concern that copyright remain a tool to incentivize creators and not a means to enlarge or enhance market power.

By way of introduction, I am president and founder of TVT Records, one of the largest, free-standing, independent record companies in America. By free standing, I mean we are neither owned or funded or distributed by or otherwise aligned with any of the five multinational music companies.

Like many independents, ours is a story of most unlikely success. Armed with almost no capital and less experience, my company sprang from an odd collection of old TV themes. Back then, independents were considered a low-rent farm club. The major companies owned the charts, and the notion of an independent having a hit without the help of a major label was most unlikely. Happily, times have changed and today independent records grace the top of the charts every day.

As an independent, TVT is part of a community of thousands of entrepreneurs and artists responsible for one of the most vital segments of the U.S. music industry. Collectively, our market share is some 17 percent of domestic retail sales, a market share greater than four of the multinational music companies and second only to that of Universal.

Beyond our collective market power, the independent community plays a unique role as the principal spawning ground for new artists and new music movements. It is by virtue of the independent community's constant prodding and rejuvenation of the music scene that we as Americans enjoy such a diverse choice of music and such a productive and profitable music industry.

Independent entrepreneurs, artists, and society are beneficiaries today of what is essentially a level playing field with regard to music marketing and distribution. This allows consumers to hear a broad array of music on the radio, to find it at their record stores, and to embrace it as they so choose. And they do so with unpredictable results that no record company, no matter how well capitalized, can sit idly by, comforted with the notion that their past success is a predictor of future outcomes.

This level playing field also allows copyright creators, the artists upon whose gifts and talents we so depend, to create with the knowledge that, beyond themselves, the ultimate arbiter of taste will be the public. The hallmark of the music business is the public listens to songs and artists, not record companies. Ideally, those songs and artists compete with one another in a marketplace of musical ideas.

With the advent of the digital age, the greatest threat to the composition of the music industry, its vibrancy and independent

spirit, is the emergence of new barriers between music providers and the market discipline exerted by public demand. Some years ago, decidedly without the authority of rights to do so, Shawn Fanning introduced the world to a profound new notion. What this notion depended on, aside from the misappropriation of music copyrights, to which I will return, is unfettered access on an even-handed basis to the idealized infinite jukebox. It is, I would argue, this freedom to choose from everything in existence that has so ignited the passion of Napster users. It is the freedom to choose which has so inspired and renewed people's love of music online and the freedom to choose that underlies the digital music revolution. It is freedom, and not free-ness or the absence of cost. For, surely, while copyright owners may not have been recompensed through Napster's infancy, clearly many others have been able to monetize the consumer's passion for digital music.

As the advertisements for a wide array of hardware makers currently attests to, enjoyment of online music has been a major driver of computer sales and has helped fuel extraordinary growth for ISPs and infrastructure providers alike. Music file sharing has earned itself recognition as the killer Nap.

Once security issues are addressed—and security must be addressed—the question becomes: What will this new digital world look like? The genius of Napster is that all music is available on an equal footing and that the consumer's choice prevails. Our concern is that, without Congressional scrutiny, any service such as Napster that requires consent of all copyright owners may be unfairly dominated by the few owners of the most content. The result would be a two-class system of copyrights where the copyrights that are owned and aggregated by multinational corporations are treated one way and the copyrights of everyone else another.

We have already begun to experience that firsthand, and right now our lawyers are in New York in front of a Federal judge and jury defending our copyrights against a company that has taken the viewpoint that, while the major labels were entitled to substantial damages and licensees with regard to their copyrights, independent labels were not.

Such a two-class system of copyright, one that places copyright value based on who owns it and what market they can exert, would be a tremendous setback to our fertile entertainment economy.

The various announcements of entities being fostered by the major record labels, all are consistent in their failure to acknowledge the necessity of a scheme whereby all content creators are treated equally. None of these vehicles to date, as far as I can tell, have made it clear that the creation of a level playing field is one of their organizing principles. Indeed, the very opposite seems to have been expressed, that is, by all these vehicles, with the exception of Napster.

I should point out that TVT, while in a lawsuit with some online companies, has been not slow to offer its content on the Internet. Since 1999, our entire catalogue has been made available free to the consumer on a timed-out and secure basis. And we remain No. 1 in the number of secure downloads provided to consumers.

More recently, we were the first label to recognize that once Napster had expressed its willingness to acknowledge copyright

and to establish a scheme to compensate all rights holders, that we had indeed reached the goal of our litigation with them. Thus, we became the first label to withdraw all of our claims against Napster and entered into a license agreement with them for their anticipated new secure music subscription service.

Amongst all entities vying to provide music online in a responsible and secure manner, Napster alone has promised to create a platform on which all rights holders may compete on the basis of quality and appeal of their content. This commitment to equal access and opportunity may never come to fruition if Napster is not successful in persuading the major content owners to grant it rights.

Under such a circumstances the question arises: Can a marketplace in which a few entities control so much content produce a universal delivery system in which equal access and equal opportunity, financial and otherwise, is provided to all? The question is one that I believe the Committee must consider to be an issue of importance. If the largest aggregators of content are able to leverage their market power to gain undue advantage, then they will be allowed to transform a mechanism intended to incent creation into a mechanism that perpetuates the current marketplace status quo. Such a distortion of copyright policy would institutionalize current content owners' positions of dominance in the marketplace and shift the benefit of copyright law from creators to the largest of aggregators.

The unique nature of the phenomenon introduced to us all by Shawn Fanning has the potential to open up a whole new horizon to all content owners and consumers alike. I welcome the Committee's scrutiny of the marketplace as it works through these many new and interesting challenges and hope the Committee's continued interest in the matter will assist motivating our industry's leaders to indeed lead us toward a fair and equitable market solution, one that will neither limit consumer choice or create inequities among content owners.

Chairman HATCH. Thank you, Mr. Gottlieb.

[The prepared statement of Mr. Gottlieb follows:]

STATEMENT OF STEVE GOTTLIEB, PRESIDENT AND FOUNDER, TVT RECORDS

Mr. Chairman and distinguished members of the Committee, good morning and thank you for inviting me to participate in this hearing. I am both honored and humbled to be here among such highly celebrated business colleagues and legendary recording artists. My purpose in appearing before you today is to address how in this digital age, copyright remains a tool to incent creators and not a mechanism to enlarge market power.

By way of introduction I am Steve Gottlieb president and founder of TVT Records, the largest freestanding independent record company in America. By freestanding I mean we are neither owned by; funded by; distributed by; nor otherwise aligned with any of the five major multinational music companies. Like many independent labels ours is the story of the most unlikely success. Fresh from school with degrees from Yale and Harvard under my belt, I foolishly undertook to license Americas best-loved and appreciated music, namely our TV themes, and assemble them in a compilation called Televisions Greatest Hits. The resulting vinyl LP, for alas that was the poor state of our music technology at that time, became a worldwide success. From those humble beginnings, armed with almost no capital and even less experience, I began my assault on what was then a music establishment of 6 major record companies. Back in those days independents were considered to be a low rent farm club at best. The major record companies owned the charts and the notion of an independent having a hit record without the "help" of a major most unlikely.

Happily times have changed and albums from independents regularly grace the top of the bestseller charts. So too has TVT changed.

From a one-man shop in 1985, TVT now employs well over 100 people and enjoyed sales in excess of 50 million dollars last year. Our roster now extends well beyond TV themes running the musical gamut from hard rock to pop to hip-hop to R&B to alternative. Through TVT SoundTrax, our label is also a force in motion picture soundtrack albums including releases from such top films as Steven Soderbergh's Oscar nominated "Traffic"—a film I am proud to be associated with as, I hope, Sen. Hatch is as well.

As an independent, TVT is a member of a community of thousands of entrepreneurs and artists responsible for one of the most vital segments of the US music industry. Collectively our market share is some 17% of domestic retail sales, a market share greater than four of the multinational music companies, and second only to that of Universal. This figure perhaps understates the size of the independents' share of music that most engages the public's interest. To wit, in the major labels' own filings against Napster they have acknowledged that a full 27% of the music files shared were non-major titles. Beyond our collective market power, the independent community plays a unique role as the principle spawning ground for new artists and new music movements. It is by virtue of the independent community's constant prodding and rejuvenation of the music scene that we as Americans enjoy such a diverse choice of music and such a productive and profitable music industry.

Fellow entrepreneurs, artists, and society are all beneficiaries what today is an essentially level playing field with regard to music marketing and distribution. This level playing field allows consumers to hear a broad array of music on radio, to find it at record stores and to embrace it as they choose. And embrace it they do—with such unpredictable results that no record company, no matter how well capitalized, can sit idly by comforted by the notion that their most recent success will have any bearing on their ability to identify, attract, and support tomorrow's most popular artist. As the marketplace continually reminds us, picking tomorrow's stars is, at best, a low percentage game.

The hallmark of the music business is that the public listens to songs and artists—not record companies. Ideally, those songs and artists compete against one another in a marketplace of musical ideas. This competitive framework has evolved from and depends upon a combination of laws, regulations, judicial rulings and market forces. For example, laws against both Payola and concentrated radio station ownership, combined with the discipline of market forces, insure that radio stations are always searching for what excites the listener. Failure to do so would only create opportunity for competitors to gain an advantage in the marketplace. Similarly retailers, who can ill afford to drive a customer across the street, are forced by the marketplace to stock whatever consumers demand. This proximity to public yields an essentially open marketplace.

Where there is a lack of marketplace competition—wherein parties are isolated from the discipline of public demand—as in the area of music video television, the results are informative. There, the majors have demonstrated both the desire and ability to exploit their market dominance so as to deprive independents from gaining an amount of airtime devoted to their artist that is anywhere near commensurate with their marketshare.

Moving beyond these examples to our current dilemma, the advent of the digital age brings the greatest threat yet to the vibrant composition and independent competitive spirit of the music industry. This threat is the emergence of new barriers between music providers and the market discipline exerted by public demand.

Some years ago, decidedly without the authority or rights to do so, Shawn Fanning introduced the world to a profound new notion and tapped directly into this market demand. His notion of having immediate access to the entire world of music without limitation has allowed a wholly new and unique way of interacting with music as transformative, different, and disruptive an innovation as the radio. This powerful concept was instantly understood and embraced by the public in an unprecedented manner as something with no real world equivalent. What this innovation depended on (aside from the misappropriation of music copyrights to which I will return) is unfettered access on a democratic and evenhanded basis to the idealized infinite jukebox. It is, I would argue, this freedom to choose from everything in existence that has so ignited the passion of Napster users; it is this freedom to choose which has so inspired and renewed people's love of music online; and it is this freedom to choose that fuels the digital music revolution. It is freedom—not freeness or absence of cost. For surely while copyright owners may not have been recompensed through Napster's unauthorized infancy, clearly many others have been able to monetize the consumer's passion for digital music. As the advertisements for a wide array of hardware and software makers currently attests to, enjoy-

ment of online music has been major driver of computer sales and has helped fuel extraordinary growth for ISP's and infrastructure providers. Music file sharing has earned itself recognition as the killer "Napp". And peer to peer sharing will certainly be an application that will grow to accommodate and encompass other forms of intellectual property.

Once security issues are addressed, as they must be, the question becomes what will this new digital world look like? The genius of Napster is that all music is available on an equal footing and that the consumer's choice ultimately prevails. If this is something we all value, if this free choice is as important to us as the underlying free expression itself, how can we preserve it? In my opinion, Napster and the overwhelming public support it has received, attest to the fact that a service such as they have envisioned by opening up universal desktop access to all music on some limited, controlled, and licensed basis deserves careful consideration as something quite possibly in the public interest.

Our concern is that without Congressional scrutiny, any service, such as Napster, that requires consent of all copyright owners may be unfairly dominated by the few owners of the most content. The result would be a 2-class system of copyrights wherein the copyrights owned and aggregated by multinational corporations and represented by professional trade associations are treated one way—and the copyrights of everyone else another. In this potential future what becomes significant about the economic reward accorded to copyright is not so much the nature of the copyrighted content but rather the nature, or more specifically the market share of its owner. We have already begun to experience that firsthand. Right now, TVT's lawyers are in New York in front of a Federal Judge and jury, defending the copyrights of our artists against a company, MP3.com, that has taken the peculiar viewpoint that while major labels were entitled to substantial damages and license fees with regard to their copyrights, independent labels are not.

Such a 2-class system of copyrights that places copyright value based on who the owner is and what market power they can exert would be a tremendous setback to our fertile entertainment economy. Similarly, the various announcements of entities being fostered by the major record labels have all been consistent in their failure to acknowledge the necessity of a scheme where by all content creators are treated in an even-handed fashion. A lack of equal treatment serves to, in effect, shift the benefits and protections conferred by copyright away from creators whom copyright law is meant to reward and to the largest aggregators of such copyrighted content. This shifting landscape undermines the level playing field on which creators have historically enjoyed a fair expectation that they will be able to compete. None of these vehicles to date, as far as I can tell, have made it clear that the creation of a level playing field is one of their organizing principles. Indeed, the very opposite seems to have been expressed—that is by all these vehicles with the exception of Napster.

I should point out that TVT, while in a lawsuit with MP3.com, has not been slow to offer its content on the Internet. We are particularly proud as a label to have a history of "firsts" on the Internet. We were the first label to invest in Reciprocal, a major digital rights management security firm. We were the first label to adopt Microsoft's Secure Windows Media format with regards to our label's musical output and believe we remain to this day the label to have delivered the largest number of secure music files via download to the consumer. In November of 1999 we put our entire catalog online free to the consumer on a timed-out and secure basis. More recently, we were the first label to recognize that once Napster had expressed its willingness to acknowledge copyrights and to establish a scheme to compensate all rights holders, that we had indeed reached the goal of our litigation with them. Thus, in January of this year, we became the first label to withdraw all of our claims against Napster and entered into a license agreement with them for their anticipated new secure music service.

Amongst all entities vying to provide music online in a responsible and secure manner, Napster alone has promised to establish a system that acknowledges rights of all content owners and recognized the central importance of creating a platform on which all rights holders may compete—compete on the basis of the quality and appeal on their content. This commitment to equal access and opportunity may never come to fruition if Napster is not successful in persuading the major content owners to grant it rights. Under such a circumstance the question arises: Can a marketplace in which so few entities control so much product, produce a universal delivery system in which equal access and equal opportunity, financial or otherwise, is provided to all content owners?

The question is one that I believe this Committee must consider to be an issue of importance. It is my opinion that rewarding copyright aggregators at the expense of copyright creators is antithetical to the spirit of the law. If the largest

aggregators of content are able to leverage their market power to gain undue advantage over smaller copyright owners in the exploitation of copyright, then they will be allowed to transform a mechanism intended to invent creation into a mechanism that perpetuates the current marketplace status quo. Such a distortion of copyright policy would institutionalize current content owners positions of dominance in the marketplace and shift the benefit of copyright law from individual creators to the largest of aggregators.

The unique nature of phenomena introduced to us all by Sean Fanning has the potential to open up a whole new horizon to all content owners and consumers alike. While, in my opinion, intervention may currently be premature, I do welcome the Committee's continued scrutiny of the marketplace as it works through these many new and interesting challenges and sincerely hope the Committee's ongoing interest in the matter will assist in motivating our industry's leaders to indeed lead us toward a fair and equitable market solution—one that will neither limit consumer choice or create inequities amongst content owners.

Thank you.

Chairman HATCH. Mr. Berry, we are honored to have you with us. We look forward to hearing from you.

**STATEMENT OF KEN BERRY, PRESIDENT AND CHIEF
EXECUTIVE OFFICER, EMI RECORDED MUSIC**

Mr. BERRY. Mr. Chairman, Senator Leahy, and members of the Committee, my name is Ken Berry. I am president and CEO of EMI Recorded Music, and I have been in the music business for nearly 30 years. EMI is the world's third largest recorded music company and the world's largest music publisher. Over the years, we have been home to artists such as Frank Sinatra, the Beach Boys, the Beatles, Garth Brooks, and Janet Jackson.

EMI Recorded Music develops, promotes, markets, and distributes music to fans, and we embrace any technology that makes music more accessible and enjoyable for the consumer. The Internet is the most exciting and revolutionary technology to impact our industry ever. It is also much more than a new medium for promotion and distribution. It is a transforming one, for fans, artists, and record companies alike.

My message to this Committee is simple: EMI is embracing this medium. We are working to create a legitimate digital marketplace, to make our music easier to access for consumers. In order to achieve this, we are making significant investments in our company to adapt to the digital marketplace. EMI alone has signed three dozen deals in the past 2 years to make music available online from North America to Europe to Australia and the Pacific Rim.

Name a new business model, from direct-to-consumer to business-to-business, and chances are we have embraced it. Name a mode of digital delivery, and recordings in the EMI library are probably online in it already, or will be very soon. We are opening kiosks, portals, digital downloads, customized CDs, and music videos on demand.

Just yesterday, as you heard from Dick Parsons, we announced EMI's participation in MusicNet with two other record companies and real networks to create a technology platform and music clearinghouse to license on a non-exclusive basis companies seeking to sell subscription services. All of our deals have a common goal: to expand the availability of our music in a manner that protects our and our artists' rights.

We are proud of the progress we have made at EMI, and we are excited still about the possibilities that lie ahead. A critical obstacle stands in the way of these possibilities. Some of the companies to whom we have licensed our rights are finding it difficult to build viable businesses in an environment dominated by the unlawful downloading of our entire catalogue for free.

Mr. Chairman, it is impossible for legitimate innovators to compete with those who say the rules should not apply to them. At EMI we are excited at the prospect of this great digital transformation. The opportunities that the Internet brings to the music community are limitless, and the biggest winners are the fans, who will have faster, more convenient access to our global music catalogues.

Like all of my employees, I am in this business because I love music, and I have had the good fortune to work with many outstanding artists. I want to thank the members of this Committee for your long-standing support for intellectual property rights, and I would be happy to answer some questions later on.

[The prepared statement of Mr. Berry follows:]

STATEMENT OF KEN BERRY, PRESIDENT AND CEO, EMI RECORDED MUSIC

Mr. Chairman, Senator Leahy, Members of the Committee, my name is Ken Berry and I am President and CEO of EMI Recorded Music. I have been in the music business for nearly 30 years.

EMI is the world's third largest recorded music company and the world's largest music publisher. Over the years we have been home to artists such as Frank Sinatra, The Beach Boys, The Beatles, Garth Brooks and Janet Jackson.

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Just yesterday we announced EMI's participation in MusicNet, a partnership with two other major record companies and RealNetworks to create a technology platform and music clearing house to license, on a nonexclusive basis, companies seeking to sell subscription services. All of these deals have a common goal—to expand the availability of our music in a manner that protects our and our artists rights.

While we are proud of the progress we have made at EMI, we are more excited about the possibilities that still lie ahead.

A critical obstacle stands in the way of those possibilities. Some of the companies to whom we have licensed our rights are finding it difficult to build viable businesses in an environment dominated by the unlawful free downloading of our entire catalogue. Mr. Chairman, it is impossible for legitimate innovators to compete with those who say the rules shouldn't apply to them.

At EMI, we are excited at the prospect of this great digital transformation. The opportunities that the Internet brings to the music community are limitless. And the biggest winners are the fans who will have faster, more convenient access to our global music catalogues.

Like all of my employees, I am in this business because I love music and have had the good fortune to work with many brilliant artists. I want to thank the Mem-

bers of this Committee for your longstanding support of intellectual property rights and would be happy to answer any questions.

Thank you.

Chairman HATCH. Thank you, Mr. Berry.
Mr. Kearby, we will take your testimony now.

**STATEMENT OF GERALD KEARBY, PRESIDENT AND CHIEF
EXECUTIVE OFFICER, LIQUID AUDIO, INC.**

Mr. KEARBY. Good morning, Mr. Chairman and distinguished members of the Committee. I would like to thank Senator Hatch and Senator Leahy and the other members of the Committee for the opportunity to be here today.

My name is Gerry Kearby. I am the co-founder of Liquid Audio. I began my career 30 years ago here in Washington, D.C., where I played music for the Marines down at Marine Barracks and 8th and I. In the early 1980's, I developed technology for rock and roll bands in the Bay Area like the Grateful Dead and the Jefferson Starship. In the mid-1980's, I developed technology for LucasFilm that became the first digital audio editing tool for film and audio production. My partners and I formed Liquid Audio to provide a secure environment for digital delivery of music. My job here today is to tell you that the ability to secure and distribute music is not a roadblock. The technology exists right now.

We founded the company in 1996, and we founded it as an end-to-end security system to distribute copyrighted material on the Internet. There was a lot of technology involved: encoding and hosting and digital rights management, which is known as the DRM business now, retail integration, distribution, consumer fulfillment, reporting services, and payment of copyright royalties.

Our DRM is one of the most widely used systems to protect music copyrights today. We have over 13,000 artists from more than 1,200 record labels that use our technology to sell their music today. In addition to the liquid format, we also distribute in Windows media format for Microsoft, and Microsoft named Liquid Audio as the key distribution channel for Windows media content.

So beyond the encoding of music, distribution of music is very important. We have built a channel of over 1,000 retailers, everybody from Amazon and Best Buy, Billboard, CDNOW, Tower Records, and Yahoo!, to 200 radio stations. We connect major record labels and independent record labels to 1,100 music program directors around the country in order for these record companies to get their music quickly to radio as it breaks.

Our consumer software enables millions of consumers to enjoy music, to download it, where the rules apply, to burn it to CDs or put it out to a portable device.

We have developed an open platform that is compatible with many formats, including MP3, RealNetworks, AOL's WinAmp, Microsoft Windows Media, and Sony's Open Magic Gate.

We have been providing security since 1997 when we partnered with Capitol Records actually to sell a download from a major artists. The challenge here is the balance of security with the consumer's need for the ease of use. Consumers will be driven to illegitimate channels as long as the technology provides overly strict kind of controls and as long as they can't find all the music they want.

Since 1997, we have worked closely with artists and record labels, retailers and consumers to improve the secure download experience. We have been successful at doing it, and this technology exists today.

I would like to quote Mr. Barry here. The system has been accepted and approved by major record labels, Mr. Barry said. We have elected to include Liquid Audio's digital download format because it allows us to offer our music securely and at a very high quality, using an easy online purchase process.

So security is not a barrier to providing the music that the consumers want on the Net. Liquid Audio provides a proven security system that is used by major labels and independent labels, by many thousands of music retailers and consumer product companies.

So why, then, are there tens of millions of consumers turning to unauthorized sites to obtain digital music? The answer is simple. The music most people want is not available for purchase through legitimate channels. The good news is that millions and millions of consumers are excited about digital music, but those consumers must be attracted to legitimate sites.

We are optimistic that the current marketplace can be changed, and now it is incumbent upon all of us to demonstrate that copyrights can be respected and that music can be accessible in every format, every car, and every portable device.

We don't believe that all or even the vast majority of users of the illegitimate music-sharing systems are cyber shoplifters at heart. We believe that consumers will embrace and pay for systems that are legitimate, easy to use, and reasonably priced.

But that can't happen unless all the music consumers want is made available, including access to all the rich and varied catalogues owned by the majors and the independent record labels.

With the assistance of this Committee, encouraging record labels and content owners to work with all participants who add value to the music industry, fans will remain loyal and the music economy will grow for all legitimate participants.

The problem before us does not involve a failure of the copyright system or of technology, but a failure in the marketplace. It is time to address this failure before the damage is irreversible. We look forward to further encouragement from this Committee and other Members of Congress to make the dream of widespread music delivery a reality. This effort will help the entire industry and satisfy the millions of fans who are excited about digital delivery of music.

Thank you very much for the opportunity to testify.

[The prepared statement of Mr. Kearby follows:]

STATEMENT OF GERALD W. KEARBY, PRESIDENT AND CHIEF EXECUTIVE OFFICER,
LIQUID AUDIO, INC.

I. INTRODUCTION

Good morning Mr. Chairman and distinguished members of the Committee. My name is Gerry Kearby and I am the Chief Executive Officer of Liquid Audio. I would like to thank Chairman Hatch, Senator Leahy and the other members of the Judiciary Committee for the opportunity to appear before you today to speak about an important topic: Online Entertainment and Copyright Law. I am a co-founder of Liquid Audio and have spent my working life in the music business. I began my 25-year music industry career playing in the United States Marine Corps band.

After that I was a sound engineer for bands such as the Grateful Dead, Diana Ross and the Jefferson Starship. I was one of the first pioneers in the digital music industry when I built components for the first digital audio editing tools for LucasFilm Limited. My partners and I formed Liquid Audio to provide a secure environment for the delivery of digital music over the Internet.

II. LIQUID AUDIO

Founded in 1996, Liquid Audio created and deployed the first, and most widely adopted solution for the secure delivery of digital music over the Internet. Liquid Audio provides a complete end-to-end infrastructure to use the Internet as a low-cost environment to distribute copyrighted music. This includes encoding, hosting, digital rights management (known as DRM), distribution, retail integration, consumer fulfillment, reporting services and payment of copyright royalties.

Liquid Audio has been first in every key area of digital music delivery. Some major record labels use Liquid Audio for a limited amount of music released thus far—a few hundred titles. The majority of EMI online retailers have chosen Liquid Audio as their digital service provider. The Liquid Audio DRM is one of the most widely used systems to protect music copyrights. The Liquid Catalog of 150,000 independent record label tracks is the largest collection of secure independent music. Finally, Microsoft named Liquid Audio “the key distribution channel for Windows Media content.”

Liquid Audio has a proven its secure distribution system for the Internet marketplace that enables musicians, record labels and retailers to publish, and securely distribute digital music to online consumers. Highlights of the Liquid Audio system include:

- **1,200 Record Labels**—Liquid Audio’s secure distribution solution enables more than 13,000 artists from 1,200 independent record labels to securely distribute their digital music.
- **Network of 1,000 Music Retailers**—Liquid Audio’s retail integration solution enables more than 1,000 retailer’s Web sites, including Amazon, Best Buy, Billboard, CDNOW, Tower Records and Yahoo!, to promote and sell digital music to consumers.
- **Over 200 Radio Stations**—Liquid Audio’s radio promotion network coordinates the promotion and distribution of new record releases, and through our joint effort with R&R Music Meeting, extends this reach to thousands of radio stations across the United States.
- **Millions of Consumers**—Liquid Audio’s consumer software enables the millions of consumers visiting the 1,000 sites in our network to download and enjoy digital music.

Liquid’s solution enables content owners to promote and sell their music in a variety of formats. Our Retail Integration and Fulfillment Systems (RIFFS) enables retail Web sites to sell music downloads from the 150,000 track Liquid Catalog. Liquid also provides a state-of-the-art consumer software application enabling users to preview, purchase, download, organize and export digital music in a secure environment. Finally, Liquid Audio’s distribution platform is open and compatible with many formats and technologies including MP3, RealNetworks, AOL WinAmp, Microsoft Windows Media, Liquid Audio, Sony ATRAC3, AAC and Dolby Digital AC-3.

Thus, Liquid Audio’s digital music distribution system is a comprehensive, secure platform that is delivering music in a legitimate, user-friendly environment to millions of customers today. Because it is open and scalable, Liquid’s system is capable of serving all of the needs of its existing users as well as millions of more users to access the music they demand while satisfying the needs of artists and labels to provide for security and compensation.

Knowing we could not build an industry alone, in 1998 Liquid Audio became a founding Board member of the Digital Media Association (DIMA), a trade organization of more than seventy member companies that provide legitimate, copyright-compliant music and audio-visual services for consumers, creators and business partners.

III. DIGITAL MUSIC SECURITY

The primary challenge is balancing security with ease of use. Consumers will be driven to illegitimate channels by overly strict controls and complicated procedures. Since our founding, we have listened to and worked closely with artists, writers, publishers, record labels, retailers and consumers. Liquid Audio has been successful in developing a user-friendly system. Our four-part digital music security solution protects music on the Internet today. Those four parts are:

- **Copy Control.**—Liquid Audio’s system enforces usage rules set by content owners that mandate how consumers can use their content, including rules on the number of secure copies, exports to devices and time-outs.
- **Distribution Management.**—Secure protocols protect all parts of the Liquid Audio distribution system to prevent unauthorized acquisition of content as it moves from publishing through Internet distribution, downloading and reporting. Liquid Audio has developed a territory management system that ensures compliance with international licensing obligations.
- **Usage Tracking.**—Liquid Audio is able to uniquely identify each piece of music. Liquid Audio can embed indelible and inaudible DRM information into the audio waveform as a watermark or in digital files as an encrypted header. The embedded information identifies and tracks audio usage and cannot be removed without destroying the recorded music.
- **Royalty Payments.**—Liquid Audio’s reporting system allows for timely and accurate accounting for music use and distribution of the corresponding royalties to creators and content owners.

Liquid Audio’s digital music security system is flexible. It allows artists and labels a variety of security options when delivering music, and it allows users a variety of options when consuming the music.

Liquid’s digital music security system has been tested and approved—as demonstrated by use today by thousands of companies. EMI Recorded Music’s CEO, Ken Berry said: “We have elected to include Liquid Audio’s digital download format and software in our trial because it allows us to offer our music securely and at a very high quality, using an easy online purchasing process.

In addition to our retail network, some 1,200 record labels from majors to independents including Atlantic, Artemis, Capital, MCA, Zomba and edel AG labels, and artists such as Lenny Kravitz, Dave Matthews Band, Don Henley and Aimee Mann use the Liquid digital music security system. Finally, Liquid’s security systems are embedded in consumer products.

Security is not a barrier to supplying all the music consumers want on the Internet. Today, Liquid Audio provides a proven digital music security system in use by major labels, many independent labels, music retailers and consumer product companies.

IV. THE INTERNET MUSIC “PROBLEM”

Over the last several months I have been dismayed and frustrated by the extraordinary traction in the marketplace and public attention awarded to companies that do not respect the law, or do not respect the copyrights of creators and producers. I am dismayed because it is difficult to compete with companies that have seemingly unlimited resources combined with disrespect for the law. But I am as frustrated with the response of the copyright owners to litigate rather than compete. That response has been detrimental to themselves, to the recording artists and to otherwise trusted partners such as Liquid Audio.

As a result of Napster, tens of millions of consumers who otherwise would have been willing to pay a fair price for quality online music have been conditioned to obtaining music for free. Creators and producers of music and other entertainment products have been forced to expend enormous resources to defend their copyrights. This has diverted their attention and resources away from legitimate partners like Liquid Audio that can help develop the ultimate marketplace weapon—competitive alternatives.

It is hard to blame millions of consumers for obtaining compelling music that is easily accessible and free. Some may find their actions unlawful, but the judicial system would be overwhelmed and artists’ fans would become their enemies if creators used the law as their only weapon. As noted below, Liquid Audio proposes a competitive marketplace solution. Napster has proven there is a market. Now the rest of us must work collaboratively to compete. In addition to litigating where appropriate, creators and record labels must turn to their trusted partners for assistance—not just Liquid Audio but several trusted partners, including our technology company competitors.

V. THE INTERNET MUSIC SOLUTION—THE CONTENT

Liquid Audio’s digital music distribution system not only respects the copyright rules and protects the content, it provides an attractive environment for Internet users to legitimately experience and acquire music. As I noted earlier, although Liquid was the first, there are a number of other companies not present here today that are fully prepared to provide these secure services and have devoted them-

selves to the same effort. The stage is set for a competitive marketplace that will serve the needs of music fans, artists and their record companies.

Why then are tens of millions of users turning to unauthorized sites on the Internet to obtain digital music? The answer is simple. The music most people want is not available for purchase through legitimate Web sites. The good news is that millions and millions of consumers are excited about digital music. But those consumers must be attracted to legitimate Web sites.

Liquid Audio is optimistic that the current marketplace can be changed. Now, it is incumbent upon all of us to demonstrate that copyright can be respected and music can be accessible in every format, in every home, in every car and on every portable device. We do not believe that all or even the vast majority of the users of illegitimate music download systems are "cybershoppers" at heart. We believe consumers will embrace and pay for services that are legitimate, reasonably priced and easy to use. Online resellers using a secure online system, such as Liquid Audio's, will be able to add value to attract consumers to their sites and will provide a legitimate Internet digital music experience.

This cannot happen unless all the music that the consumers want is made available, including access to all the rich and varied catalogs owned by the major and independent record labels. Defining price points and business models in an open and competitive marketplace is never easy, and there will always be Napster progeny that promote taking rather than purchasing. But with the assistance of this Committee, by encouraging record labels and content owners to work with all participants who add value to the music industry, fans will remain loyal and the music economy will grow for all legitimate participants.

VI. CONCLUSION

Liquid Audio is optimistic that the current unfortunate state of affairs can be reversed. The Ninth Circuit has ruled. Now we must show our fellow citizens they can respect copyright yet still acquire the music they want, when they want it, where they want it, and how they want it. Liquid Audio stands ready to provide those services. But we can only provide the music consumers want if all music, and not just a token sample, is made available by the copyright owners on reasonable licensing terms.

We appreciate the efforts of the members of this Committee, and their encouraging remarks that record labels and content owners should work with all of the legitimate participants in the online music community to create a secure and competitive marketplace.

The problem before us does not involve a failure of the copyright system, but a failure in the marketplace. It is time to address this failure before the damage is irreversible. We look forward to further encouragement from this Committee and other members of Congress to make the dream of widespread legitimate online delivery of digital music a reality. This effort will help the entire music industry. It will also satisfy the innumerable music fans who are excited about the digital delivery of music but have not been able to find a broad and deep online music experience that offers them legitimacy and value.

Thank you for this opportunity to testify today.

Chairman HATCH. Thank you, Mr. Kearby.

Ms. Rosen, we look forward to your testimony.

STATEMENT OF HILARY ROSEN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, RECORDING INDUSTRY ASSOCIATION OF AMERICA

Ms. ROSEN. Thank you, Mr. Chairman.

I listened eagerly at the outset to the opening statements, Mr. Chairman, of you and Senator Leahy, and I heard the words that people were concerned about piracy. For me, this hearing is not about piracy. It is about opportunity.

While it is tempting to respond to a lot of what I have already heard this morning, I think you have an idea, at least, of what it has been like for record companies trying to get into this space with a lot of thoughtful additional opinions about how we get there.

Napster was exciting, but giving away someone else's music, frankly, without their permission is yesterday's news. On the screen before you are samples of dozens of Web sites with whom record companies have signed licensing agreements and on which fans can find digital music right now.

I am going to keep talking as this is playing, but the story is about plans to bring new services that will offer even more variety, better audio quality, and new features to the marketplace as soon as possible.

Mr. Parsons and Mr. Berry have already talked about the announcements from their companies, about their partnerships with RealNetworks. Other companies, like Sony and Universal, have formed ventures to offer subscription services which they are going to launch later this year. Many independent record companies have also signed such deals.

On the other side of these efforts lies a new frontier for music fans. Today's hearing and the many participants on this panel are evidence that there are several moving parts to this issue. There is a host of technology-related issues from identifying partners and finding technologies, like Gerry Kearby's company. We are actually one of his many competitors. The systems and business models that have a chance of succeeding with consumers have to be thought through. This whole grand experiment is about the consumer and the music fan and how to create even more passion for music and its delivery.

Of course, the music starts with the artist, musicians and songwriters. Without their talent, without their passion, there would be no consumer demand and no music industry to fulfill that demand. Record companies have already started to consult with their artists in individual discussions to assure that these new business models offer fair returns for everybody. More needs to be done.

Negotiations are underway with music publishers and songwriters, for they also must be fairly compensated, and I am confident that those negotiations will succeed.

Has our start been too slow? Perhaps. But measured against the scope of the challenges, we have moved at an extraordinary pace, and I have no doubt that the current efforts underway are immense and determined. The marketplace is moving correctly and it is moving quickly, and we can provide and protect the incentive to create along the way.

We all know that what is done in this space for music has great import for all entertainment products and for all domestic policy—the legal precedents, the public policy responses, and the marketplace acceptance by consumers. We are grateful to this Committee for the opportunity to discuss these issues and, indeed, America's record labels are proud to be in the forefront of this amazing period of change, and we are confident that the outcomes will be wonderful for creators and music fans alike.

Thank you.

[The prepared statement of Ms. Rosen follows:]

STATEMENT OF HILARY ROSEN, PRESIDENT AND CEO, RECORDING INDUSTRY
ASSOCIATION OF AMERICA

Mr. Chairman, Senator Leahy and members of the Committee, thank you for the opportunity to appear before you today.

The title of this hearing is "Online Entertainment and Copyright Law: Coming Soon to a Digital Device Near You."

It's an apt title, Mr. Chairman. But if you'll excuse me for borrowing the senatorial parlance, I have an amendment to offer. Because online entertainment isn't coming soon. It's here . . . and it's getting better everyday.

Napster was exciting. But giving away someone else's music without their permission is yesterday's news.

The story now is the music industry's efforts to alert fans and consumers to the huge amounts of legitimately licensed music that is currently available on-line. And the story is about our plans to bring new services that will offer even more variety, better audio quality and new features to the marketplace as soon as possible.

The goal is to have several different kinds of systems and business models for music fans to choose from, available in as many locations on-line as possible, on a nonexclusive basis to encourage competition—and to make these services and products compatible with new hand held devices and other technologies that are emerging around the corner. To achieve this goal, America's record labels are licensing innovatively, constantly and aggressively and they are in some cases putting finishing touches on systems that they have built themselves.

Flashing on the screen before you are samples of the dozens of web sites with whom RIAA member companies have signed licensing agreements and on which fans can find digital music right now. And these are in addition to the hundreds of statutory licenses already in place for webcasting.

Just yesterday, three companies with major record companies, AOL Time Warner, EMI and Bertelsmann announced a partnership with Real Networks' to create MusicNet, a technology provider and a music clearinghouse to license its platform to companies seeking to sell subscription services under their own brands. It has been widely reported that two others, Sony Music and Universal Music have formed a venture to offer subscription services which will launch this year. Many independent record companies have signed similar licenses and are using their catalog in innovative ways to bring music to the consumer. Portals and web sites will combine these services to offer aggregated music services to consumers.

Building entirely new businesses is a complex endeavor. But we're approaching this challenge the same way we know any member of this committee would handle a piece of legislation—sorting through the issues as quickly but as thoroughly as you can, and doing all you can to bring the diverse interests involved together.

Is it easy? Of course not. Is it worth it? Absolutely.

Because on the other side of our effort lies a new frontier for music—one in which garage bands have a global audience, songwriters can compose with their brethren an ocean away and fans have unlimited choices and record labels have unparalleled opportunities.

Like any new frontier, when it comes to exploring this one, taking short cuts would short-change the people and possibilities we are trying to reach.

TODAY'S HEARING VALIDATES THE COMPLEX ISSUES RECORD COMPANIES HAVE FACED

The make up of today's hearing panel symbolizes the complex issues record companies are facing as they work to coordinate the diverse interests involved in bringing music online.

TECHNOLOGY ISSUES

Finding the right technologies and the right technology partners to help build systems is a key first step. Gerry Kearby and his company Liquid Audio have been in this space from the start tweaking their technology several times as the marketplace evolved. I can only imagine the frustration he has felt when at each stop along the way another technology company has joined the fray as a competitor; and sometimes as soon as a decision is made, a new advance is made technologically.

There are systems issues like determining compatibility for the multiple devices that are currently on the market and those that might be developed in the future. What interfaces are required for consumer use? Should the system be adaptable to multiple kinds of business models or will separate systems be built for each service? Is the music database digitized in the proper formats to give flexibility to develop new services?

And there are many others: Which technology do you use to compress and decompress content? What combinations of encryption and watermarking should be used to protect the content? What levels of protections should be associated with each different business model? The consumer is always in the forefront of this discussion. How do you devise a system that's as easy to use as placing a CD in a CD player? Then there is the so called "back room" operation. You need customer service for

when the downloads or streams fail to materialize and you need to fashion transaction systems that work with multiple outlets. You need clearinghouses to assure that royalties are paid to the right people for the right activity.

All of these questions are important and they are being answered every day. And not just for the United States, for these are global issues. For if there is one thing this Committee well knows, the Internet is a global distribution system and it must be treated as such. You simply can't have a long-term successful business if you are not thinking about multiple territories.

ARTISTS AND SONGWRITERS

Don Henley and Alanis Morissette personify what we all know—that artists and songwriters and musicians are the soul of the music business—that the Internet represents an extraordinary opportunity for them—and for record companies to succeed, they must succeed. A relationship between artists and labels must be defined that works for the Digital Age.

Artists have historically had a one-to-one contractual relationship with the record company that relies on the sale of individual albums. Yet some of the new distribution systems rely on consumer access to multiple artist's works for fixed prices in a subscription based model. It is important that individual artists are compensated fairly and these discussions take time. In any business, contract discussions can be messy and sometimes lengthy. But this is a very important issue to the record companies and there is a strong commitment on their part to comprehensively addressing it in the work on new distribution systems. Progress has been made on this front but more needs to be done.

And artists need access to information to do their own distribution if they aren't signed to a record label. These artist's ability to protect their own copyrights and enforce their rights against pirates are as important to them as it is to the record companies.

We also need licenses from songwriters and music publishers, Le.: NMPA's constituency as well as ASCAP, BMI and SESAC—to do our business. We have arrangements in place for simple downloading of full songs, but new models such as subscriptions are being discussed right now. Coming up with a standardized royalty rate for all manners of business models—most of which haven't even been invented yet—is a daunting task, but we're committed to getting it done.

RETAILERS

As Mike Farrace here from Tower Records On-line will tell you, 97 percent of music sales are still brick-and-mortar transactions—and we have to ensure that on-line distribution enhances rather than undermines the commercial viability of our retail partners. In addition, retailers have valuable customer relationships with both the sales of physical goods as well as downloads. Those relationships are important and is certainly the subject of many discussions between retailers and record companies.

These are all exceptional challenges. Measured against their scope, we have moved at an extraordinary pace. Clocked in Internet speed, I think it has been too slow. We all do. But I have no doubt of the intensity of the effort currently being made and the determination to be successful. The marketplace is working and we do not need additional legislation to assure progress.

I am amused by those who suggest that record companies don't want to be on-line with legitimate music—that we don't want to serve our customers. It is a ridiculous notion that should be given no credence by this Committee or this Congress. We are a huge industry trapped inside a small physical package. Our freedom from selling only physical CDs or cassettes means a huge expansion worldwide in the artists we can support, the diversity of music we can offer and the commercial potential we can unleash. We understand that better than anyone else and we are taking the most active steps to embrace the opportunity.

THE CONSEQUENCES OF ON-LINE PIRACY

There is one way to overcome every one of the challenges mentioned above—to accelerate online music to real-time speed—to cause every legal or technical complication magically to disappear.

And that's to break the law.

Because once you conclude that piracy is permissible and intellectual property is worthless, licensing is a snap. Technical protection becomes a breeze. And royalties are no great shakes either.

I don't believe that anyone on this Committee or in this Congress supports piracy—in physical form or in the on-line arena. And over the last few years, the courts have gone a long way to define exactly what constitutes on-line piracy. We are pleased with these court decisions. The courts have confirmed that piracy exists both when there is obvious mal-intent but it also occurs when seemingly well-intentioned people launch business services using copyrighted work without first securing licenses. The notion that the latter type of piracy is morally or economically permissible in the guise of technical innovation has been resoundingly rejected by the courts and should be by this Committee.

We look forward to Napster complying fully with the requirements the court has imposed. To date they certainly have not—but I remain optimistic and am committed to working productively with them in this regard. Indeed, several of our member companies who are plaintiffs in this case have committed to licensing Napster once they have a legal service to bring music online in a manner that takes advantage of peer-to-peer technology while respecting intellectual property. One of our member companies, Bertelsmann, is even funding their entry into this legitimate marketplace.

I believe that disputes are best avoided when ground rules are most clear. Innovation is produced most quickly when intellectual property is protected most rigorously.

We stand ready to defend those principles—not just for ourselves but for all of the partners in the chain of a legitimate digital music business. All of those companies you have just seen me flash though deserve the benefit of a lawful marketplace. They can't compete otherwise.

THE FUTURE IS BRIGHT AND THE MAP WILL BE DRAWN FOR OTHERS

The frontier of online music isn't in courtrooms. It's on computers. It isn't in disputes. It's in digital devices. And above all, it isn't in litigation. It's in innovation.

The challenges involved in building a legitimate market for online music are daunting. Were the opportunity any less immense, they might not be worth the cost.

But the opportunity is that immense. The frontier of digital music—is that thrilling. To be sure, the legitimate road may be a bit longer—but taking a short cut would shortchange the music fans on whom our industry depends.

We are doing this right—and we are moving quickly—and we can protect the incentive for innovation along the way. Indeed, America's record labels are proud to be in the forefront of this amazing period of change and we are confident that the outcomes will be wonderful for music fans and creators alike.

Thank you.

Chairman HATCH. Thank you, Ms. Rosen.

This has been a really interesting panel, and we are sorry that we have to have so many witnesses, but you are all critical to our understanding. We have had a wide variety of interesting comments here today that were very thoughtful, reflective, and very much consternation to us on what to do and what needs to be done.

Mr. Parsons and Mr. Berry, Ken Berry, let me ask you this question to begin. I have been encouraged by the reports of the record labels' taking significant steps into the online distribution space, as Ms. Rosen has helped us to understand, especially the announcement of the alliance of Warner Music, EMI, and Bertelsmann with RealNetworks to form MusicNet. Nevertheless, some concerns remain.

What assurances can you give us that this alliance will foster open competition among online music distributors and retailers, allowing diverse companies like Tower Records On-line, for instance, or Liquid Audio or the new Napster and so on to use their own music players and digital rights management systems to keep their own customer information to compete with America OnLine, for example, as a music service provider? Let's start with you, Mr. Parsons.

Mr. PARSONS. Thank you, Mr. Chairman. First of all, a word about MusicNet in terms of what it is and why we think it expands

opportunity for everybody. MusicNet is going to be, in essence, a B-to-B platform that aggregates the music initially of the three companies you just identified, namely, Warner, EMI, and Bertelsmann, and hopefully, going forward, all of the music available. In other words, we will be seeking to get licenses from the other majors and the independents, aggregate all that music, and make a service available to other distributor platforms that are looking to create relationships with consumers, so that MusicNet will not have a direct relationship with the end-user consumer but will have relationships with affiliated or syndicated platforms, like AOL, like RealNetworks, or like any of the platforms you just mentioned. All of those we will try and deploy this service as widely across as many different distribution platforms as possible.

So the key to this thing is that MusicNet, using the real technology, will have a secure, convenient, easy-to-access, in essence, turnkey product to distribute to other platforms that have relationships with consumers. It is non-exclusive so, in other words, it doesn't detract in any way from the existing competitive landscape. What it does is it adds a powerful new alternative for distributors to go to for, in essence, the turnkey solution to get access to deep and rich music content.

Chairman HATCH. Mr. Berry, do you care to comment?

Mr. BERRY. Mr. Chairman, as Mr. Parsons has already said, the arrangements we are entering are non-exclusive, and it is intended to accelerate the process of getting music into the Internet space and make it easier for consumers to find a broad aggregation of music. But it is not our sole access to the consumer, nor is it the exclusive way in which we intend to exploit our music in the Internet space.

We have entered into, as I said earlier, many licenses and will continue to enter into new licenses in the future in order to accelerate this process of getting music out there in the Internet arena. We have even said, as you probably know, in the press comment yesterday that when Napster has their viable new business model which respects the rights of artists and record companies, we will be prepared to talk about entering into a license there with that new model.

Chairman HATCH. Thank you.

Mr. PARSONS. In fact, if I just might add?

Chairman HATCH. Mr. Parsons?

Mr. PARSONS. Ken makes a good point that neither side of this relationship that the music companies have created with MusicNet is exclusive. MusicNet will be offering this service to a range of distribution platforms, and all of the music companies are not exclusive to MusicNet. They will also be entering into, in the fullness of time, their own relationships with other aggregators of their content. So this is just one new way to go.

And we did, in fact, not only agree to consider licensing Napster, but in the agreement itself, it provides that MusicNet service will offer an affiliation and a relationship to Napster provided that Napster simply meet certain conditions of security and legal operation that were set forth in the agreement. So that is done.

Chairman HATCH. Thank you.

Mr. Valenti, I think you summed up the importance of the totality of these industries as well as anybody has ever done so before this Committee. And I think you have done a great deal of service in helping us all to understand how important not just movies but music and everything else is.

Having made that statement, I would like to ask Mr. Henley and Ms. Morissette a question. Digital distribution systems like the Internet allow the artist and the music fans to connect in a new way. It offers a more transparent mechanism for accounting to artists for the use of their works. And it might even create some cost savings for music fans.

What could intermediaries like the record labels and technology companies do, and what reforms might Congress make to most significantly harness the opportunities offered to artists, especially niche artists, and their fans? And I would welcome responses from anybody on the panel, but let's start with you, Mr. Henley, and then go to Ms. Morissette.

Mr. HENLEY. Well, Congress can help by fostering an atmosphere of openness and communications between the record companies and the artists. We are very concerned about fair compensation, not only just getting paid for music on the Internet but how much we get paid and what kind of licensing system there will be. We are concerned about who is going to collect these digital royalties and how they will be disbursed to recording artists.

Chairman HATCH. Do you have any doubt that what Mr. Ken Berry and Mr. Parsons have described will also include the artists and the writers, the creative people in the royalty distribution?

Mr. HENLEY. Well, I would certainly hope so. As I said in my testimony, up until now the dialog has only been between the record companies and the Internet companies, and we have been excluded basically from that dialog. And we would like to be a part of it in the future certainly.

Chairman HATCH. Mr. Parsons, did you want to answer that question?

Mr. PARSONS. To be sure, Senator, the artists, as I said in my opening statement, it all starts with the artists. We have no intention of excluding them, frankly, either from the discussion, the ongoing discussion of how the business should roll out in the online world and most particularly from their fair share of the proceeds from this. In essence, each of the record companies that are signed up to this have obligations to their artists and to the publishers, which we fully intend to honor on a go-forward basis.

Chairman HATCH. And to the writers as well? In other words, you are including them with the artists as well?

Mr. PARSONS. Absolutely. And I think the first bridge that we had to build, however, had to be to kind of create a model in the marketplace that, if you will, was different than the Napster model; in other words, a model that enabled someone to have a digital rights management system that you could capture revenues around the use of this copyrighted material, and then the allocation of it will be determined either in accordance with pre-existing contractual relationships or, frankly, in many instances, we will have to go back to artists, writers, and publishers and negotiate new terms.

Chairman HATCH. Ms. Morissette, would you care to comment?

Ms. MORISSETTE. I am in support of dialoguing and focusing on the present and going forward with this new digital era. There have been dynamics in the past that have not been in favor of artists, to say the least. And I think that artists are more open to dialog, I think, now more than ever. So I am open to dialoguing about it, and I am open to creating new forms of, you know, transparency, really, of where the money is coming from and who it is going through, and ultimately how it is divided up, as I said earlier.

So I think at this point in time, artists more than ever are open to being included in those dialogs and being part of that creation of the solution.

Chairman HATCH. Thank you.

Mr. Henley?

Mr. HENLEY. It is important to remember what I said in my testimony earlier, that recording artists do not at this time have protection in terms of a public performance right for interactive services. That has to be created.

Another concern is the issue of recoupment. As I also pointed out earlier, the publishers do not recoup advances against the writer's share of royalties. And if some sort of collection agency is created by the record companies, such as Sound Exchange, we would like to hear the record companies say that they will not use that collection agency as simply another pool from which they can recoup advances for tour support, for promotion, things of that nature.

So there are a lot of excruciating details that need to be worked out in this new world.

Ms. ROSEN. Mr. Chairman, can I just make a comment on that?

Chairman HATCH. Yes.

Ms. ROSEN. I don't want the Committee to be under the impression that there is not a copyright for certain uses. I think the issue that Mr. Henley is referring to is that in certain limited instances there is a statutory license that is administered collectively for radio-like Web-casting. Interactive services are more akin to the direct distribution rights of record companies, of book publishers, of film companies. Those are administered on a contract-by-contract basis. So there is no collective licensing of those rights and, therefore, no fear for artists about a collective body diverting those rights. Those rights are administered individually by copyright owners by contract, the same way that physical record sales are administered.

So I think that there are a host of issues for individual record companies and their individual artists to talk about in terms of whether or not their contracts provide for those services, but the right clearly exists and it is important.

Chairman HATCH. My time is up, but I would like to ask just one other question to you, Mr. Barry, and Mr. Kearby as well. Do the recent announcements like the ones made about MusicNet give you more hope that your companies will be licensed by the record labels?

Mr. BARRY. Well, Senator, when I heard the announcement yesterday, my first thought was that we ought to have a hearing like

this every week because I think it does move things forward a bit. But I think there are—

Chairman HATCH. I am game, but—

[Laughter.]

Mr. BARRY. Permanent oversight might be a good idea.

Senator LEAHY. We will do a compulsory licensing hearing next week.

Chairman HATCH. Compulsory hearings.

Mr. BARRY. I think yes, and the questions really that are still out there are the ones I raised in my testimony. In order to enable this Internet music, we are going to have to have rights to the entire catalogues. We are going to have to have rights to musical compositions as well as sound recordings. And I would ask Mr. Parsons and Mr. Berry whether rights to musical compositions are included within the licenses they are giving to MusicNet, for example.

I also say that—there was a discussion about technical requirements, security requirements. I think those are absolutely appropriate. They need to be established and administered in a very open and even-handed basis and not to require technology from any particular vendor but rather be open standards.

I think that, as Mr. Gottlieb said, we should have the same terms for all. There shouldn't be cross-licensing, as you, Senator, were concerned about last year, that it be an even playing field, as Steve said, so that, for example, the deals that are made between AOL and EMI are no different than the deals that are made generally for MusicNet.

Then, finally, I think it is really important that we allow people other than the major labels to participate in these industry-wide structures.

Chairman HATCH. Thank you.

Do you care to comment, Mr. Kearby?

Mr. KEARBY. Yes, sir. I think we are encouraged by the announcement of MusicNet. We are concerned that unless all of the content is available from all of the record labels, we won't have a wide enough audience for this, and people will be stuck in a Beta and VHS land where one technology supports one set of record labels and another technology supports another.

I can and should state that we are dismayed, really, to consider that the record labels would go and directly discuss with Napster licensing. We think that rewards years of illegal behavior, and we think that companies like Liquid Audio and many of our competitors who have lived by the rules for the last 5 years shouldn't be disadvantaged by a company that aggregated so many millions of consumers by providing intellectual property for free.

Chairman HATCH. Thank you.

Mr. Valenti, I am going to come back to you. I just have to ask this question. You know, I can see the many conflicts and problems here. There is no question about it. Without the artists, without the writers, you wouldn't have the product. Without the consumers, you wouldn't have any buying of it. Without AOL, EMI, et cetera, et cetera, you wouldn't be able to—artists wouldn't have a chance to get their stuff out there and have the funding to make things work.

Mr. Valenti, I can't tell you how much your remarks impressed me here today because of what the totality of the entertainment industry means to our balance of trade and the enjoyment that people have all over the world and how America is the No. 1 leader throughout the world. You make that case very well.

But I have been sitting here thinking that maybe there are some other solutions as well. If you go to compulsory licensing, you are talking about violations of the GATT Treaty. So it is not a simple thing to do. It is a very complex thing to do, and it is the last thing anybody really should want to do, in my opinion, unless, like Mr. Henley says, it is the last resort to resolve this.

But I remember a number of years ago I came up with the idea to do an orphan drug bill. Now, you might think, what has that got to do with music, movies, entertainment, et cetera? But at the time they were developing three or four orphan drugs a year in the pharmaceutical industry. But we put a very small incentive, a tax incentive, into orphan drugs, and today there are well over 200 orphan drugs. And these are orphan drugs to help populations of 200,000 or less.

I am wondering if there isn't some way that we could maybe even put some incentive into this system so that you don't have some of these conflicts, so that there may be a way of resolving all of these problems. I can see Mr. Hank Barry's position that if you are going to do a deal with RealNetworks and it is non-exclusive, why can't you do the same deal with him or with Mr. Gottlieb or anybody else, for that matter? If you do that deal, why can't the artists and the writers be paid, and why can't their royalties be secure? Why is there this conflict and this feeling?

I think RIAA is very, very important in this whole thing. No question about it. You do a great service. Without you the industry wouldn't be as solvent or as strong as it is. So every one of you plays a very important role.

I would like you all to think about this. Maybe something like the orphan drug incentives that created a mass of orphan drugs that have benefited people who would never have had those pharmaceuticals had it not been for us having some minor, but yet important, incentive.

Now, think about it, because that may be an answer that might help all of you. It may be just another lame-brain Hatch idea. You never know. But I will do my best to try and help the industry.

I don't have any axe to grind here. I want to see it work. I want to see it really—Senator Leahy particularly liked the “lame-brain Hatch idea” phrase.

Senator LEAHY. When did this ever happen?

[Laughter.]

Chairman HATCH. But just think about it, would you? Then help this Committee, because we don't know what to do. We know we are going into a new age. We know that music is going to be disseminated in far different manners than it has ever been disseminated before. We know that the idea of gold records and platinum records is going to be a thing of the past. We know that online is where people are going to get most of their music. We know that the whole business plan or various business plans have got to be revised and revamped. We know that artists are very upset and

concerned. We know that writers are very upset and concerned. We have seen a lot of writers who have discontinued their contracts because the industry is concerned. There are a lot of really talented people who have no chance whatsoever, because we can't come up with the solutions to these problems and provide the incentives to really help far more people, not just artists and writers and consumers but the businesses themselves.

This is an area that I really love to consider, an area I really love to work on. I would really love to help all of you. You can see the conflicts and the disparities. Your comments on that, and then I will quit.

Mr. PARSONS. May I, Mr. Chairman?

Chairman HATCH. Yes.

Mr. PARSONS. It does seem to me you have pointed out the tip of the iceberg of complexity around these issues. They are enormously complex.

Chairman HATCH. They really are.

Mr. PARSONS. And the interests are competing at various levels. But I do think, back to what I was saying in my comments, you know, you have to have some faith in the marketplace in terms of working through these issues. And if your Committee fails to see progress, it seems to me that is when the yellow flags go up.

But I submit to you that progress is being made. Progress is being made because—

Chairman HATCH. It seems to be, but it also seems to be very slow in the making. And, you know, one of the things that bothers me is that music can be on the radio and royalties are paid and people are taken care of. It is kind of just accepted. Why is that not possible on the Internet?

Mr. PARSONS. I think—

Chairman HATCH. I understand every company wants to have its own Web page, its own distribution system, its own right to control some product. But, still, it's not that way on radio.

Mr. PARSONS. I just think it takes time for those conflicting and competing and complex interests to work their way out. But the great incentive here is—frankly, we are all in business to make money now, I grant you. The artists are in business, as Don Henley and Alanis say—

Chairman HATCH. And you are all critical to—

Mr. PARSONS.—first and foremost to create, you know, an artistic vision or expression. But there is a little bit of money underlying that as well. And we will figure it out, and I think we are figuring it out. And I think the MusicNet transaction is—

Chairman HATCH. But do I have to hold a hearing every week to get this figured out?

Senator LEAHY. Well, it actually worked. You got AOL Time Warner and EMI to announce the Bertelsmann RealNetworks, the MusicNet Sounds. I mean, Lord knows what we get next week.

Mr. PARSONS. I assure you, we didn't just go to work on that last week.

[Laughter.]

Senator LEAHY. I understand that the timing is great. I am going to have a question on—

Chairman HATCH. Senator Leahy, I have taken way too much time. I apologize. But I have to say that this Committee is very concerned about all these issues. I don't want any of you to feel like this Committee is not considering your thoughts. But as you can see, there are a lot of different ideas here, a lot of different conflicts, a lot of different problems. There is no simple way of solving it. But I have thrown out this idea of perhaps some sort of an incentive that might bring you all together. I don't know. But I know we couldn't do anything in orphan drugs until we wrote this simple bill, and today there are millions of people being helped, small groups of people who never would have been helped before, and from those orphan drugs we have had major blockbuster drugs developed as extensions of them.

So there may be some way we could do this. I hope you will help us.

Mr. Barry, you look like you want to comment on this.

Mr. BARRY. Senator, I would just echo your comments. I think that we have a marketplace here that is extraordinarily slow to mature, and we have seen in the past with respect to the Satellite Home Viewer Act, the Digital Performance Rights Sound Recording Act, the Copyright Act modifications with respect to cable television that every once in a while Congress has to step in and enable these new marketplaces.

I will just give you a quote from September 1997: "The Internet presents the recording industry with tremendous opportunities, and already some companies are experimenting with the online delivery of music directly to consumers on demand." I mean, this has been—this is Carrie Sherman from the RIAA.

This is a long-standing issue, and I really believe—I think that there is good faith on both sides here—in fact, on all sides. And there are many sides. But I think that this question of all these varying rights, the complexity of the rights situation is really the issue. And I know the music publishers are here today. I think that they are absolutely key to this discussion as well.

Chairman HATCH. Mr. Henley, you have indicated you wanted to say something.

Mr. HENLEY. Yes. Thank you, sir.

Most of this discussion here today has been about distribution of music on the Internet and the digital revolution. I would just like to point out—and I know we don't have time to go into it here today, but perhaps we could come back another time and discuss some of these other issues. There are historic issues concerning problems between the artists and the recording industry, including copyright ownership, as manifested in the work-for-hire issue that has still not been worked out, despite a directive from the Congressional Committee where we had the hearing last May. So there are still serious issues regarding work for hire that need to be addressed. There are issues regarding the nature of the standard recording contract. There are issues such as the 7-year statute in California, which is the crux of the Courtney Love lawsuit.

All these issues need to be scrutinized by Congress so that the playing field can be leveled. It will be nice to work out the digital revolution, but we have some things going back 50 years that we would like to come and talk about at some point.

Chairman HATCH. We would be glad to listen.

Senator Leahy, sorry.

Senator LEAHY. Thank you. No, I find it interesting because you speak of the orphan drugs and the others, but there are also some in the Senate—and the House, for that matter—who feel that we don't want to build the technology, nor could we, or the business model, nor could we, that we may jump-start everything through compulsory licensing. I am not suggesting that is what this Committee would do by any means, but I would not want anybody to leave not realizing that there are some in the House and Senate who feel that way. Probably one of the important things about having a hearing like this is to get all sides heard.

Mr. Parsons, you mentioned earlier and were making the comment that, of course, MusicNet did not get put together overnight in time for this hearing, and as one of the witnesses said, "Isn't it ironic?" the announcement was made just before the hearing.

My question is: When will this become real? I realize we had the announcement before the hearing, but when will we actually have MusicNet?

Mr. PARSONS. Well, good question, Senator. I think that, just to take a step back for a moment, these companies have been working toward this objective for quite some time. If there was a seminal event or catalytic event, I will call it, I would refer more to the decision of the Ninth Circuit in the Napster case that sort of said, look, these are the rules of the road going forward, now stop living in a dreamland of hope that somehow you can avoid the copyright laws and their application to the online world, and get about the business of creating legal models. And that is what I think put a little bit more fire on the efforts, because I would remind the Senator that we at Warner Music Group have been associated with RealNetworks on MusicNet for over a year, we brought the other guys in.

But when will it be real? It is real now. The licenses that were granted to MusicNet as a result of this agreement exist. The terms exist. The licenses for distribution between MusicNet and AOL and Real exist and were signed. What still is in beta testing is the actual technology, the digital rights management technology that is going to make all of this work. Real and MusicNet are in their beta testing. I think they will actually be out in the market probably the middle of this month with that test, and we at AOL are looking to be marketing the service late summer, early fall.

Senator LEAHY. The reason I ask, somebody mentioned the 1996 Communications Act. I remember us being told just go ahead and leave us as much flexibility as possible, cable rates, for example, will come down. They didn't. They went up. We will offer a lot more services. Service didn't get a heck of a lot better in most of the cable systems, certainly not Fairfax County where it is somewhere in the 50's or 60's in its quality and ability. I only mention that because I am familiar with that one as a user. I can usually get a better picture off my rabbit ears. But that is for some of us older people who remember that expression. Younger folks here won't. But I also think of the optimism we had about the satellite home viewer Act, but we are still waiting for many of the access in some of the rural areas, and I worry about this.

But let me ask both you and Mr. Ken Berry, I understand you are going to license your music to MusicNet on a non-exclusive basis. Am I correct in that?

Mr. BERRY. That is correct.

Senator LEAHY. I think that is going to be good news to the music retailers. They have sold your music for years in brick-and-mortar shops as well as online. They obviously don't want to be cutoff from your music catalogue.

How do you respond to Mr. Farrace's concern that you may use your power to "steal our customers" and "all retailers just want a level playing field and let them decide how to market and sell music"?

Mr. BERRY. Well, EMI Music's policy has been for many years to try and make our music ubiquitous. We would like the consumer to encounter our music in as many environments as we can possibly get it to. We don't assume that the consumer will come to us. We need to go and find them.

To that end, we have worked closely with a lot of retailers, and we were amongst the first to do it, to build relationships so that if we were in the world of digital downloads, for example, we did it through retail sites.

Now, clearly, new media does bring for the first time the ability for record companies to deal directly with individual consumers, but my expectation is that there will be many services offering music to the consumer, and we will need to service a number of different intermediaries between us and that consumer, some of which may indeed be retail organizations.

Senator LEAHY. Let me follow a little bit up on that. Ms. Rosen has testified that the RIAA member companies have licensed dozens of Web sites—we saw some here earlier—to provide music for downloads and for streaming, in addition, I think, to hundreds of statutory licenses for Web-casting. And I think that is a great step forward. I have said for some time that litigation against unlicensed sites is only a partial answer. You can't just say, well, we are going to close down sites and not provide legitimate alternatives to obtain digital music. People want to be able to obtain digital music, the beauty of having every copy exactly the same and exactly the same quality.

Liquid Audio and Tower have licenses to deliver some music online. But Mr. Kearby from Liquid Audio and Mr. Farrace from Tower have expressed concern that the music most people want is not available through legitimate sites. Mr. Farrace says only a small percentage of the millions of songs available in CD are authorized for digital sale. And right now actually Napster may have the biggest offering, which I suspect is one of the explanations of its popularity.

Mr. Hank Barry said, "To this date, no service has been able to provide a comprehensive offering of music on the Internet that is licensed by the major recording and publishing companies."

So, Mr. Parsons and Mr. Ken Berry and Ms. Rosen, why isn't there something like the equivalent, the digital equivalent of Tower Records up and running, first off? And—well, let's take that first off.

Ms. ROSEN. Senator Leahy, I think it is important to sort of put this issue in perspective about the nature of the offerings and the timetables under which they have occurred.

At the outset, the expectation was that people wanted a singles-driven online business, because that is what they couldn't get currently from albums. So everybody wanted to be able to buy singles. Gerry Kearby invented a great system—he has some competitors in this system—to sort of sell downloaded singles. All of the record companies provided those downloadable songs, some through aggregated partners and also through individual sites.

What happened then was that Napster created a scenario where it was essentially everything you wanted all at once, in essence, kind of an “all you can eat” approach. The consumer liked that idea, you know, as other people today have said. They liked the idea of being able to think up any song, going up to Napster, and pulling it down. So the business model thinking has completely evolved since that time.

But Napster a year ago said that they wanted a legitimate service. They still haven't been able to build one. They have \$50 million from one of my companies. They still haven't been able to build a legitimate legal service. This is not easy to do.

What the record companies did when the Napster phenomenon came on was said: This is an interesting thing and we are going to learn from this, because we understand how our consumers have started to think and started to consume music. So we have got to prepare our back rooms, our technology service providers, we have got to find legitimate partners in the space to help us build subscription-based services, the so-called “all you can eat” services.

That essentially started last year. That takes a lot of time. Hank Barry hasn't been able to get it done either. So the only reason he has got all the music is because he doesn't license any of it.

So it has got to be very clear to this Committee and to the public that the evolution of the music offerings on the Internet have been quite thoughtful, quite deliberate, and really have changed with the consumer mind-set.

The other thing that I think is worth pointing out is that there is not a single industry making any money on the Internet, except the sex business. You know, they are the only ones who have figured out how to actually sell products through the Internet. And so the fact—

Senator LEAHY. Are they on the Internet?

Ms. ROSEN. I have heard. I have heard.

[Laughter.]

Ms. ROSEN. Although I am sure no one around here would actually have been a customer.

The fact is that there is a lot of legitimate companies like Mr. Kearby's, like all of those ones I have showed, that are actually trying to compete in the marketplace, attract more investment capital, get more funding, and get more attention to their sites. It is very hard to do that in an environment where Napster continues to operate, No. 1. And, No. 2, as you are following the consumers' wants and needs, the technology and the assets required to back that up are enormous. I think you have heard these companies are commit-

ted to providing that, but this has not been sort of a slow process. This has been an evolution of consumer demand.

Senator LEAHY. You don't have any question that you envision a future where there will be a profitable sale or can be a profitable—

Ms. ROSEN. I don't have any question about it.

Senator LEAHY.—sale of music on the Internet.

Ms. ROSEN. And, to be honest, I resent Mr. Barry's suggesting that it is too slow when he himself hasn't been able to do it legitimately.

Mr. PARSONS. Before we—

Senator LEAHY. Let me get Mr. Parsons and Mr. Ken Berry, and then I have a question for Mr. Hank Barry who might follow up on this.

Mr. PARSONS. Let me just say the vision you just outlined is exactly what the MusicNet model is all about. Essentially, we, EMI, BMG—and I would point out that EMI and Warner Music Group are the largest publishing entities; we own the greatest number of copyrights out here in terms of a deep catalogue—have essentially licensed that catalogue so that for the first time you now have companies with deep, rich catalogues, licensed catalogues, to the MusicNet service to be made available.

Now, one of the reasons I said we are going to actually not be in the marketplace with the product is not just technology, but we have to clear the rights. I mean, we have gone through a sample, I think, of about 70,000 songs that we would put on day one to see with respect to that sampling—and as I have said, we have got over a million copyrights. So we took a sample of 70,000. We went through to see where we have the full complement of rights, not just from the music companies but from the artists, from the writers, from all of those constituencies Senator Hatch mentioned a moment ago.

We have got to clear those rights and make sure that whatever we turn over to be available for downloading we have got the rights to do that, and then the money will follow back to the rights owners.

It is a much simpler task if you basically disregard or ignore everybody's rights. But I wanted to leave this on a hopeful note. The MusicNet service that we announced is exactly what the Senator has in mind in terms of a place you can go and get everything.

Senator LEAHY. Well, and keep in mind what I have said probably a dozen times in hearings like this and a hundred times elsewhere, I want the artists, the performers, those who have invested in them, to get a return on their investment. I don't want Mr. Henley or Ms. Morissette to go out and see their songs that they have worked hard on, that are popular because of their unique contribution to it, to be available free—

Mr. PARSONS. That is what takes some of the time.

Senator LEAHY. Mr. Ken Berry, you wanted to say something, did you, before I go to Mr. Hank Barry?

Mr. BERRY. Just to repeat a little bit what Dick Parsons said a moment ago, we have had to build systems in our respective music companies that can, first of all, digitize the content wherein so it can be manipulated and, furthermore, build systems that will track the revenue bank so the artists actually do get paid, which are not

issues with these free services where our content is being given away. It is a very significant investment, and it clearly has taken some time.

Of course, we do invest an awful lot in our artists' careers. It is not just a question of signing them. We are making big investments all the time, particularly in this new digital era, to make sure that we are set up to actually provide the full service through to the consumer. And clearing rights, as has been mentioned before by people here, is complicated, but we are in the process of doing it and we are getting the answers to this particular obstacle right now.

Senator LEAHY. Mr. Hank Barry, I believe you want to run a legitimate business. I don't mean that in a condescending way at all. I mean it very sincerely, and I have talked to you before. You have a brand name that can be very valuable, something as well-known as Coca-Cola, at least among those who are going to be using it, or we think of brands like Ben and Jerry's, coming from Vermont.

But I also believe the record companies want to share the benefits of the marketplace that you happen to build, which is a tremendous one, provided you make your system secure, No. 1, and, second, compensate the artists and the copyright owners. I am not going into the court cases. Those are pretty clear.

But I went back this weekend, and I went on your Web site, and I just wanted to check some of the things that are available. You can find the Lenny Kravitz song "Again" by typing Lenny Kravitz in the artist line and "Again" in the title line. You are not using any misspelled words or anything else. And there is a song that I believe is on Billboard's Top 10 right now. You can find a song I like, "Hotel California" by the Eagles. You simply type these words in the appropriate lines. Marvin Gaye's song "I Heard It Through the Grapevine" is there. Now, that is a song that has been licensed for various commercial uses as well.

Now, all those songs are copyrighted. I suspect there is not permission to have them there. What do you say about this? I mean, what do you do? Because, on the one hand, I see what you are trying to do. You are trying to put together an easily downloadable business. You agree, as I understand, with me that artists should be compensated. But what do we do in a situation like this?

Mr. BARRY. I appreciate the chance to respond to that because it is something that people have made a lot of contentions about.

This is the matter that is before the district court right now. As you know, the Ninth Circuit entered an order and the district court fashioned an injunction to implement that order. We are complying with that district court order, I think in an objectively measurable way. We have detailed the actions that we have taken in three separate compliance reports to the district court, one of which we are submitting today.

Since March the 5th, the total number of files available through the service—remember, it goes from the hard drive of one user to the hard drive of another—has dropped from 375 million to under 100 million. We have blocked over 300,000 separate songs with 1.6 million individual file names. We have pulled together 100,000 additional title variants, and we have licensed Grace Notes data base. We have also changed Napster's terms of use so that we are going

to bar participation of people who attempt to bypass this filtering system.

Now, is that enough? No. As we have seen, some songs get through. Is it harder to find a song? Yes. The Ninth Circuit said—and I think it is true—this is not an exact science, and we are working to make it better.

Those are the facts. But we are not asking this Committee and we are not asking the court of the plaintiffs to take our word for it. We asked the judge to appoint an independent technical evaluator—and she did so last Friday—to make sure that we are doing everything that is possible to comply with the injunction. She has appointed that independent technical advisor, and that person is going to help to find whether we are acting correctly and whether the plaintiffs are acting correctly under the injunction. So we look forward to working with that independent advisor and working harder to address the issues that you raised.

Senator LEAHY. I have other questions for the record, but one last question for Mr. Valenti, because every time I mention compulsory licenses, I see Mr. Valenti's hair stand up on end, and I can't do that anymore. Because some have called upon Congress to step in to control the licensing for music and other forms of entertainment in the online space, which in the digital world involves your industry, Mr. Valenti, how do you feel about that?

Mr. VALENTI. How do I feel about—

Senator LEAHY. Compulsory licensing.

Mr. VALENTI. Well, I think we have to understand, I am not talking about music now because that is—

Senator LEAHY. No, I am talking about for the movies.

Mr. VALENTI. Movies alone. I think we have to understand that the difference between the analog world, in which we mostly exist today, and the binary number world, the digital world, in which we will exist tomorrow, is the difference between lightning and the lightning bug. Totally different. And the reason why a compulsory license won't work, will be totally unworkable with movies, four quick points:

One, a compulsory license today for cable and satellite is defined by limited viewing areas. The cable system in Washington, D.C., doesn't go to Philadelphia. And if you have a satellite, it has to be within the footprint of the satellite. On the other hand, the Internet is global. It is instant at 186,000 miles per second and it is global. And I know there is supposed to be technology out there to contain it, but guess what? It doesn't work and it is mainly, I think, what I call the dot-com hype.

Second, I think that the independent producer would be devastated. When the independents go out to make a movie, they have to finance it themselves. They go outside the studio system. And they pre-sell their movie to various territories, to France, to Germany, to Japan, to Argentina. And if you had a compulsory license, they would be out of business. They couldn't pre-sell because there is no limitation on that reach.

Third, government price-fixing never works. I was present in the 1976 Copyright Act, and I personally negotiated with your predecessor, Mr. Chairman, John McClellan. And in those days, I don't know how it works today, but he didn't fool around with Sub-

committees and Committee members. He had all the power and, by jingo, he used it. I am sure that is the same way—

Senator LEAHY. Orrin does it exactly the same way.

[Laughter.]

Senator LEAHY. Never mind, you know, being bipartisan and everything. He still does it the same way. I come in and I have to go to his office and schmooze each morning.

[Laughter.]

Chairman HATCH. I wish. I just wish.

Mr. VALENTI. And as a result, we started out with about 7 percent of a cable system's revenues, and then it got down to 6 and then 5 and 4. And every morning when you got to John McClellan's office, he had a new lower rate. And, finally, when it got to about 1 percent, I ran up the white flag because I thought that the Senator was going to go down to zero before we were done.

As a result, today a cable system with \$9 to \$10 million in revenues pays 1.89 percent of its revenues for its compulsory license. On a satellite, a satellite pays 19 cents per subscriber for all the programming of a single broadcasting station for 1 month. Now, if ever I saw a thing that was totally out of balance, that is it.

And the fourth thing is I think that—keep in mind that if you set a rate on a compulsory license for movies, you would have to set that rate as the potential to cover the entire world because that is what the Internet does, which means that American consumers would be subsidizing the viewing of European and Latin American and Asian citizens. They would be paying the rate so that somebody else abroad could get it free. It just won't work and doesn't need to work, because the movie industry around the world has been operating for about 70 years, 80 years, back to 1913 when "The Squaw Man" came out, and it works in a negotiated basis around the world.

I might add, finally, that if you look at a cable system today, the marketplace works. For example, MTV—

Senator LEAHY. Be careful on that. They are monopolies, they give lousy service, and they don't—but go ahead.

[Laughter.]

Mr. VALENTI. I must say—

Senator LEAHY. You pay to have at least 20 preachers wearing bad hairpieces who sit on there and tell you if you will send money just to their company, you have salvation.

Ms. ROSEN. You are going to get letters, Senator Leahy.

Mr. VALENTI. Senator, I have learned one thing in my long and some would say checkered career. I never debate with a Senator.

Senator LEAHY. Of course you do, but that is OK.

Mr. VALENTI. Having said that—

[Laughter.]

Chairman HATCH. What do you mean?

Mr. VALENTI. Shall we move along? All of the programs, mostly on cable, like HBO, Showtime, USA, Lifetime, Discovery, TNT Movie Classics, these are all negotiated in the marketplace. There is no compulsory license there. All negotiated. So I can't speak about music or anything else, but in the movie business, the idea of a compulsory license is an idea whose time has not and should not come.

Senator LEAHY. Thank you.
 Chairman HATCH. Thank you.
 Senator Feinstein?

Ms. ROSEN. Senator Leahy, could I just add one thing on that with respect to music?

Senator LEAHY. Yes.

Ms. ROSEN. Sorry. A quick question. Everything that Jack said about the Internet being global and once it is licensed applies for music as well. But people should remember that there has actually never been a compulsory license that goes to the core distribution right. Any compulsory licenses that have ever been considered have always been in very limited areas of public performance, which for most—for copyrighted works are secondary or tertiary markets. When you talk about the compulsory license in this instance or the one that Mr. Barry or some others have suggested, you are talking about the core distribution right of a reproduction, and that would be a disaster.

Senator LEAHY. Thank you.

Chairman HATCH. We are going to keep the record open for questions by members of the Committee through Friday. But we are running out of time.

Senator Feinstein?

Senator FEINSTEIN. Well, thanks very much, Mr. Chairman.

I think Mr. Valenti's opening remarks really in a sense were a tribute to copyright and intellectual property laws, which have really allowed this industry, all of it—its many complex parts—to grow and prosper and really in a sense to become the envy of the world.

For my State, California, Napster was in my backyard—well, I guess San Mateo County—the movie industry is premier, and much of the foundation of intellectual property industries emerge in California. So obviously their protection is very important to me.

It is also important that consumers are able to utilize new technology and do it in a way that protects these copyright laws.

Now, since our last hearing, Mr. Barry, you went through a court case. The world is different today than it was at our last hearing. And I want to ask this question: I think you still do advocate for compulsory licenses. Is that correct?

Mr. BARRY. I think that whenever there is a feeling in the marketplace—and that is my contention, that there is a feeling in the marketplace here—then Congress has to look at it. And that is one of the options, I believe, yes.

Senator FEINSTEIN. Well, have you formulated a pricing structure that would adequately compensate artists, record labels, et cetera?

Mr. BARRY. What we are trying to do here today, Senator, is identify through all the varying views that are here on the panel and some that are in the room but not here on the panel, such as the publishers—

Senator FEINSTEIN. Could you move your mike closer?

Mr. BARRY. Oh, sorry.

Senator FEINSTEIN. I want to hear the fine points.

Mr. BARRY. What we are trying to do here, Senator—and obviously we are at the very early stages of trying to figure out wheth-

er this marketplace is working—is to define some of the rights that are involved when one goes to have a full catalogue of music available.

I will give you an example. MP3.com, which is also a company that is located in California, in San Diego, has paid over \$160 million in settlement fees with respect to sound recordings with the major labels, and yet the service associated with that is not available now. And that is because they don't have publishing rights. They don't have publishing rights to the catalogue that is associated with the sound recordings.

And I think that if I had to name one place where there is really an issue in the marketplace, it is with respect to this complexity of licensing. I asked earlier—and I don't believe I have had an answer yet—whether music publishing rights are included within the rights that MusicNet is going to provide. And I would suggest to you, Senator, that getting a license from MusicNet without publishing rights is not going to enable anyone to actually have the kind of service that we are all saying the consumer should have. And so Mr. Parsons might have an answer to that right now.

Senator FEINSTEIN. Mr. Parsons, do you want to respond to that?

Mr. PARSONS. Well, yes. As I indicated earlier, on the MusicNet, the full complement of rights to enable the streaming or downloading of our catalogues—EMI's, Warner Music, BMG's—is included in the license that we gave to MusicNet. But, Senator, I just think—you know, my colleague Mr. Valenti started this hearing off by saying, you know, intellectual property rights are private property rights. And when one thinks about a compulsory license, the hurdle that one should have to clear to say that I am going to abrogate the rights of an owner of property to determine how that property is used because there is some broader, overriding public interest applied to this space, yes, it is complicated—not that it can't be done because we just did it. It is complicated to sort through the maze of rights and to make sure the property owners are appropriately contacted and consented and paid.

But it certainly doesn't rise to the level of, you know, U.S. Congress intervention to say that it is so important that people have access to the music in this fashion that we are going to override the rights of the copyright owners, whoever they may be, and provide it on some compulsory basis.

That is why I was saying to Senator Hatch earlier, let the marketplace work. It is working and we are getting there, but the theory of Napster—and I heard the answer to Senator Leahy. It sounded to me like, you know, a thief who gets caught and then tells the judge, well, look, I am prepared to go straight and I will go to a trade school or whatever, but in the meantime, I need to continue to steal because it is all I know. I don't think that is a legitimate approach to this. I think the approach has to be to respect the rights of the people who own the property and to work through the complexities. I mean, that is what we are trying to do, and that is what we said, if Napster can do it that way, they, too, will be entitled to a license from MusicNet, which, as I say, is the full complement of rights that you need to stream and download the music that our companies offer.

Senator FEINSTEIN. Thank you. I would like to ask—

Mr. BARRY. Senator, I—
Senator FEINSTEIN. Would you like to respond to that, Mr. Barry?

Mr. BARRY. Well, you had asked me the question about whether we had a pricing mechanism in place.

Senator FEINSTEIN. Correct.

Mr. BARRY. And the answer is that I think that we are just raising the issue. This is clearly something that nobody here favors in the sense of we all would like the marketplace to work. We are all committed to that.

But as Mr. Henley said, as a last resort we have to look at this. And you can look around the Internet today, and there isn't any service that has a comprehensive license to both sound recording and publishing to make that available to consumers. There is no Internet equivalent of ASCAP. There is no Internet equivalent of any clearance organization. And so that is the point I am raising.

Senator FEINSTEIN. Yes. I guess what Mr. Parsons is saying is, if you believe that this is private property, then it is up to you to work out the individual agreements to be able to put up that private property.

I would like to ask Ken Berry a question, if I could. Napster has said many times that no one will talk to them about licensing, and they publicly stated that they would offer \$1 billion over 5 years to the record labels if they could get licenses.

I would like to ask you: Are you willing to give Napster a license?

Mr. BERRY. First of all, we have had conversations, as Hank knows, about the prospect of having a license in the future when the legitimate business model is established. And, of course, it has not been at this time and is not expected in the immediate future. So we await the outcome of the new commercial model, and we will definitely enter into serious conversations about a license at that time.

But in the offer of the \$1 billion, which was a very large number in most people's terms understand, we believe our business is migrating to the Internet, and that is where our music will be sold. And our investments in music come to many billions of dollars, just as EMI, let alone my competitors, whether they are independents or other majors in this industry, and to try and take a license to basically take over the music space on the Internet, the amount of money involved is very, very significant to compensate the music companies, which is why there is such a negative response to it.

But we are interested in talking about a license, as I heard already my colleague on the left, but a lot of companies have, as you say, gone straight and actually offered legitimate services and not tried to offer our content for free. And there is an issue about the fact that Napster is clearly offering our content for free even now, as was identified, Lenny Kravitz being one of our recordings. And this is a very serious problem for us, and we think it is very unfair on the people running legitimate models right now, trying to make a business. How can they do so in this climate where music is being given away for free?

Senator FEINSTEIN. Would Napster like to respond to that, Mr. Barry?

Mr. BARRY. Just one footnote, Senator. In the press briefing where we described our economic offer and the various economic offers we have been making over the last 9 months to the labels, we made it very clear that in the new Napster service there will not be the ability to export a file from a person's PC. So there will be limitations on burning. There will be limitations on exporting to a Rio device. And we told all of the record labels that there would be fidelity limitations. So you would have a media limitation and a fidelity limitation. So I just want to make clear for the record that was the context in which that offer was made.

And I would say further that, with respect to a possible industry-wide licensing arrangement, we would continue to make those sorts of limitations, because we actually believe that Napster is a promotional service. Most people use it to listen to, sample music before they go out and buy it. And so, therefore, these limitations on burning and limitations on export were things that we clearly stated publicly at the same time—the same day, actually, that we made that offer.

Chairman HATCH. Senator, could we turn to Senator Schumer at this time?

Senator FEINSTEIN. Thank you, Mr. Chairman.

Chairman HATCH. We are running out of time, and I don't want to completely shortchange the second panel.

Senator SCHUMER. Well, thank you, Mr. Chairman. I want to thank you and all of our diverse witnesses. Every time we have a hearing, we realize how complicated all of this is. I just want to say I start out from two places that a year ago I thought might be contradictory. I don't think they are now. One is that copyright must be protected. You just can't take people's stuff and give it away for free, no matter what your rationale is. Everyone would like to have for free. That is not how we work. And it is not fair, it is not right. And if we started doing that here, we could start—you know, it is music, it is an intangible good, but you might want to do the same thing in so many other places. But, second—and, again, I don't think these are contradictory—that digital music has to be made widely available on the Internet, because the Internet has brought so many new possibilities that it is exciting. And the question is how you protect the intellectual property, the copyright, and still use technology to give all these new advantages that people have.

For me, it comes down sort of personally. Being from New York, we have lots of people who are artists, who are would-be artists—I guess no one thinks they are a would-be artist—undiscovered artists, and lots of companies that do a great job distributing music. I am proud that New York is the music capital.

On the other hand, you know, my 16-year-old daughter banged on my door one morning and said, "Dad, you got to pass a constitutional amendment to protect Napster." The first political statement out of her mouth after all these years.

[Laughter.]

Senator SCHUMER. And basically what she did for me, she gave me the best birthday gift I ever received, which was she asked me my 16 favorite songs, she put them on one CD—this is a year ago so it was OK then, I guess—including songs that I had been in search of. When I was a kid, I had a crush on Rene Strasberg and

the song "Don't Walk Away Renee" came out by the Left Banke, and I have been trying for 20 years to get that song on my—

Senator LEAHY. Well, there is a well-known song if there ever was one.

Senator SCHUMER. It is a great song.

[Laughter.]

Senator SCHUMER. I won't sing it for you, Mr. Chairman.

Chairman HATCH. Let's not knock our artists.

Senator SCHUMER. I then went and asked my daughter to ask her friends—Mr. Henley is saying that was a junkie song, I think, to Ms. Morissette there.

Mr. HENLEY. No. With all due respect, Senator, the word "Don't" is not in the title of that song.

Senator SCHUMER. Oh, "Walk Away Renee."

Mr. HENLEY. Thank you.

[Laughter.]

Senator SCHUMER. Well, let me say this to you, sir—

Senator LEAHY. That ruins the whole story.

Senator SCHUMER. I didn't want Renee to walk away, but she did.

[Laughter.]

Senator SCHUMER. She was only going out with college guys, you know.

In any case—enough of this. In any case, I went and asked my daughter, I asked her, "Would you"—I tried to ask her about the issue of intellectual property, which I believe in. And I said, "Would you be willing to pay for this?" I would be willing to pay \$50 for that album, which is more than probably anyone would envision me being charged for it. And she said yes.

And then she on her own went and asked 15 of her friends in high school would they be willing to pay for all of this, and they said yes.

So intellectually we are no longer at a conundrum here. I think everybody sort of agrees that intellectual property must be kept and protected, and at the same time the new technologies must be expanded. And I think after hearing from Mr. Kearby and others, Mr. Parsons, Mr. Barry and Mr. Berry, that technology is there.

And so the question is: How do we get there? And I am not sure, being a novice at this, that what we are not hearing here is everyone agrees to the place we ought to get, but everyone is sort of standing in line, elbowing, they want to be the one to get there first. And that is probably true of every person at this table.

And, I don't know, it is hard for us who are not the technological experts to figure out who is right and who is wrong in all of that. And so I have a few specific questions, but I would ask the witnesses to think about this general question. Am I wrong in that assumption? Am I wrong in the assumption that we all want to get to the same place and each of us has a different way?

And then you have two conflicting things here. The record companies, whether the big ones like Mr. Parsons and Mr. Berry come from, or the littler ones like Mr. Gottlieb comes from, have something that all the rest of you folks need. They have the right to do with the music what they want.

You have the other folks, the technological people have copyrights and patents on their technology, but my guess is that there are other people who will come up with other patents on that, whereas nobody else will have the copyright on “Don’t Walk Away Renee” and other—I mean, “Walk Away Renee” and other greater songs. So that is a conundrum as well.

So I guess my general question to everybody here—and then I have three specific ones that I am going to ask, too, so I can get answers to those. But my general question I would ask to anyone to respond to, do we all think we will end up in the same place? And is this just a discussion as to who is doing it? Or is it beyond that?

And then my specifics are as follows: one to Mr. Barry of Napster, and that is, you know, you want people to make deals with you, and yet it seems to, I guess, somebody who is trying to be as objective about this that you are still allowing people to download copyright-protected materials from Napster despite court orders, despite everything else. And that would say to me, if I were lining up to make a deal with you, I don’t think I should. And so I would like you to answer that specifically. I would like to know how many people have been knocked off the system compared to how many people who are still on the system. Because if you do believe in intellectual property, that is a sine qua non, and I don’t think you would have the right—I would like to see the technology that you have started prevail. But if you are doing that, maybe you shouldn’t be the one sitting at the table making the deal.

Mr. BARRY. I understand, Senator.

Senator SCHUMER. And the second question, a specific—and then I will let everybody answer all of these in the interest of time—is to Mr. Parsons and Mr. Berry. I think the model that you guys have put together is very interesting and could work. Two of your friendly competitors have a different model. How do those come together? And then, second, what do you do in terms of contracts with smaller companies like Mr. Gottlieb’s? Do they get the same terms if they have produced and put the sweat and equity into getting a song out as the larger companies, or are they going to get a different type of deal that is not as advisable? Because I think that is important as well.

In other words, let’s assume the Big Five, it is, come together. What happens to the 17 percent of the music that is—was it 17? Or some nice, significant percentage—that is not one of the big companies in terms of how they relate to this new technology that is going to do the music.

So with that I would ask Mr. Hank Barry to answer my first question, Mr. Parsons and Mr. Berry to answer my second question, and then all of you to answer the general question that I asked, or anyone who wants to. Mr. Barry?

Thank you for your indulgence, Mr. Chairman.

Mr. BARRY. I will start with the general question, which is I do think that we all see the tremendous benefit of this and we are all going to the same place. For me, the fundamental question is whether the marketplace is going to function efficiently to get us there. And in my remarks earlier, I gave some reasons why I

thought it was not. Obviously other people have a different view. But that is my answer to the first question.

With respect to the second question—and I detailed our compliance efforts earlier, Senator; you might not have been here. But let me say generally that you have to think about how the Napster architecture works. We don't host any files. You can't download a file from Napster. You download a file from another person who is using the system at the same time. Napster is a directory, an index, with community around it with respect to the other uses who are on the system at the same time you are logged on. So it is essentially a real-time search engine. And the challenge there—which is recognized by the Ninth Circuit Court. They said this is not an exact science. The challenge that we have in complying with the district court's injunction is to identify all the files as people are logging them in, block the ones that should be blocked, and in general, as I said earlier, when people are not acting appropriately with respect to the rules of the system, removing those people from the system.

Under our previous notices, we blocked over 750,000 people from participating on the system under our DMCA notice regime. And as I said earlier, we have blocked 1.6 million files, which represent about 300,000 individual songs. And I did say earlier, Senator, that I don't think it is good enough. It is an iterative process, and we are working on it every day to make it better.

Senator SCHUMER. Has it interfered with the functioning of Napster on the street?

Mr. BARRY. It has slowed down performance—

Senator SCHUMER. I don't hear that it has.

Mr. BARRY. Well, our testing says that it has.

Senator SCHUMER. Does anyone disagree with that?

Mr. BARRY. Well, people can disagree. The fundamental point that you make, though, is that things are still available through the service that shouldn't be there, and I agree with that. And certainly the court anticipated that when it appointed last week this independent technical advisor who is going to advise the court about whether we are doing all the things that are possible in order to comply with the injunction.

So I think we are in agreement on the goal. The question is what is the way to get there.

Senator SCHUMER. Does any single person want to just answer what Mr. Barry said? Ms. Rosen?

Ms. ROSEN. I don't think I have to get into it much, except that my best analogy that came immediately to mind when he said that was when my son is hitting my daughter and she is crying, and then I tell him to stop, he says, "But, Mom, I'm not hitting her as hard anymore, so I don't want to stop."

It is sort of irrelevant, the degrees of compliance. You are either compliant or you are not.

Mr. BARRY. Yes, I think that is true, and if I could just point to a chart for a moment here with respect to our activity and blocking files on the system over the last 4 weeks, people can see that we have gone from a regime where people had access to about 375 million files to a regime where they have access to approximately 100 million. Now, that may not seem a lot, and if you can find the file

that you want, it doesn't matter to you. And we understand that. And so we are going to do a better job, and I take Ms. Rosen's point.

Senator SCHUMER. The second question to Mr. Parsons and Mr. Berry.

Mr. PARSONS. Very quickly, because I am aware of time, also. All of us in the business believe that in order for a legitimate service to find real success in the consumer marketplace, you have to have access to all the music, so that eventually I am sure there will be two, four—I don't know how many—six services up that everyone licenses, but that have different personalities and different other features but have access to all the music. But because this is America and because willing buyers and willing sellers in the normal course of commerce find each other and negotiate the terms under which they will do business, it just takes some time to assemble all that music in one place.

So we started MusicNet with three of the majors. There are obviously two majors who are not in yet, and a bunch of independents, but our objective is to get them all into the boat on this platform. There will be others. Universal and Sony are working now on something called Duet. They haven't quite launched it yet, but that will be a different technological platform. And their objective will be to get everybody in that boat so that we can have competition around presenting music online to consumers in an easy, affordable, value-added way; i.e., you come to one place, you can get anything you want.

With respect to your second question, clearly I indicated earlier that MusicNet will be out seeking to license not only the two majors but the independents. The terms of those licenses, however, will be negotiated in traditional, free-market, American commerce fashion; i.e., you have got something I want, I have got something you want, let's sit down and talk about how we come together around that.

Chairman HATCH. OK. With that, I am going to have to cut it off, because we have one more questioner, and then we are going to have to go to last panel. We are really out of time.

Senator CANTWELL. Thank you, Chairman Hatch and Senator Leahy, for calling this important hearing. Obviously the delivery of online music is testing how the marketplace and law can work together to bring new entertainment services to the many people who are here listening today.

Obviously this whole industry is quite young, and there is not a lot of history guiding us in this process. We can learn from the past when new mediums were developed, like radio or television, that oftentimes those industries were rocked and ultimately revolutionized. And I think that is what we are seeing today.

Legitimate, secure online music services are good from the consumer, and they are good for the economy. And the testimony that you have had today has tried to explain each of your vision on how we get there. Obviously artists, as Mr. Henley talked about, want more flexibility in the current business models. The music industry execs who have put time and energy into the marketing of those products want to make sure that investment is ultimately protected. The security solution providers, as Mr. Kearby is one of,

have put time and energy into new technology and think that the technology is there and ready and want to see that technology is used to deliver those new services. And consumers rightly should benefit from not only the new technology, but new business models.

So my question is, as you all now have been thrown into this online music sandbox and are being required to play together, if you will, our choices seem to be: one, as the somewhat supervising adults, to go back and say work it out; the Chairman articulated a second alternative, which would be to have, you know, this Committee continue to be an oversight and pressure point on this discussion; I don't know if I quite heard him right, but I think he mentioned weekly or every couple weeks a hearing, which seems quite extraordinary; or the possibility of legislation.

Now, by comparison, I would have to say to my colleagues, when I think about the other new economy challenges of protecting personal privacy, e-commerce taxation, I would actually say that by comparison to those, there has been a lot of progress here. Now, maybe the demand for music is more incentive than the unknowing consumer whose personal privacy has been eroded. But the issues seem to me to be those three choices.

So I would like to ask at least a couple of the panelists, others if they want to join in: How should we measure this progress in a real timeline? Is it possible in the next 6 months to see full catalogues online in a business model that consumers would accept? And I guess what I would like to do is ask Mr. Henley and Mr. Hank Barry and Mr. Kearby and Ms. Rosen specifically to respond to this. Is that the bottom line that we are negotiating? Mr. Henley, you may say not—even if we get full catalogues online, the existing model isn't flexible enough for us. I mean, artists would like to have the opportunity to have their music in certain—or, Ms. Morissette, you have obviously done this already, so you have seen the benefit of having some music out there even in a timed-out version or what have you. That is good for your overall promotion.

So are we going to see something in the next 6 months that will satisfy the consumers and the business? Are we talking about a model that is in the very, very near term going to provide that kind of benefit to consumers and the industry? Or are we talking about one of the other two choices of continued hearings or possible legislation?

Mr. KEARBY. Well, I would like to start. From Liquid Audio's perspective, when Chairman Hatch asked earlier, Does MusicNet help or hurt?, I guess the real answer to that question—and I hadn't thought of it at the time—was, well, I guess it depends on the licensing terms. And is the playing field level for distributor vis-a-vis MusicNet? Are we going to get the same pricing, therefore, be able to offer that pricing to our channels that MusicNet gets and offers to its channels?

Presuming that the answer is yes and presuming that the publishing issues are taken care of, then my answer is yes, we can have a system up and running in 6 months. We always say we are the tool makers, not the rulemakers. We will find out what the rules are relative to output to portable devices and CDs. But, yes, a system can be put into play in 6 months that protects property and has a subscription service. The real issue is: What are the pric-

ing concerns and what, if any, will the consumers, you know, require of the marketplace relative to those pricing terms?

Ms. ROSEN. You know, I am an optimist but I am also a free-marketeer, and I think that the question that you ask is a good one. But it is also what test will this be measured by. I don't think that this Congress or this Committee wants to be in a position where people are essentially forced to go into businesses that are not going to be profitable, that are going to be money-losing, that are going to be cannibalizing. I think people are trying to be thoughtful about that.

As we have said before, people are having a lot of trouble making successful business models on the Internet and other industries. So these are somewhat time-consuming.

I think the test has already actually been passed. There have been a lot of market trials and a lot of experimentation, and the intent is serious. I am optimistic that we have long passed the time in the music business where people thought that this was a "what if" proposition as opposed to a "when" proposition. This is happening, if only because a more ubiquitous environment of legitimate music available, not succeeding, cedes the territory to the pirates, and we are not willing to do that because there is no upside to anybody to do that. We want to sell music. That is why we take risks on artists. That is our business. And so this is a place where we are going to do that.

Senator CANTWELL. Mr. Henley or Mr. Barry?

Mr. HENLEY. Well, I hate to keep going back to this, but the last 15 or 20 speakers have crystallized my point about the artist being left out of this equation. As Alanis and I sit here, there is a ping-pong game going back and forth across our heads about business models on the Internet, when, in fact, we don't know how our intellectual property is going to be protected. We are already in disputes with record companies about abuses of our copyrights and our intellectual property, and the Internet gives a whole new array of ways in which our copyrights and our intellectual property can be exploited. So we need some statutory protection. We need some explanations. We need some answers about how we are going to get fairly compensated in this new Internet world from all the other people who are sitting here.

Senator CANTWELL. But I also heard you say flexibility. In some instances, you said you would be willing to forego those royalties at your own discretion. You are after flexibility—

Mr. HENLEY. I didn't say I would be willing to do that. I said if—
[Laughter.]

Mr. HENLEY. If an artist so chooses. There are many people on Napster right now who want them to distribute their music free of charge, and that is their prerogative. Having been in this business about 38 years, I don't see it that way. I don't need the promotion. I am not a new artist. If other people want to do that, that is fine with me. But I don't necessarily want to do that. But, you know, people are free to do what—if they want to give their music away, that is their prerogative, but I don't—I didn't mean to imply that I was willing to do that.

Senator CANTWELL. So if the security solution and the labels are saying in 6 months we think we will have catalogues available, we

think there will be business models that consumers can access—because there is a lot, obviously, online now. You are still saying you have concerns about the artist compensation that you wish this Committee would address.

Mr. HENLEY. Six months sounds like a very short time to me, and we still don't know how this money is going to be collected and how it is going to be distributed to artists. And, again, we are unprotected.

Mary Beth Peters, who is the head of the U.S. Copyright Office, has said that in the world of copyright, American artists are the most unprotected on the planet. And so we have grave concerns about how we are going to be compensated fairly in this brave new world of Internet. And we are not getting answers to those questions.

Ms. MORISSETTE. And I believe in the building of the new models is where we want to have our voices heard, because there is no question that not only are the new models going to be needed to be established, which I am hoping is going to be done with the three groups that I talked about earlier, but also it would be remiss of us not to reference, if nothing else, what the past models have looked like. And, you know, the dawn of this new digital era has shone light on all of it, which is part of what is exciting.

Chairman HATCH. Well, let me interrupt here. I have to say that I am challenging all of you that we are going to have a lot more hearings if your interests aren't served, because without you, without the creators and the artists, we wouldn't have anything. Without the consumers, we wouldn't have anything. Without the distribution channels, we wouldn't have anything. And without the publishers, we wouldn't have anything.

Every one of you is critical, so I am just suggesting to those of you who make and build these business plans that you make sure that everybody here is considered. And between you and me, I would like it to be done without the almighty hand of the Federal Government. I think it can be done. I agree with you, Mr. Parsons, that it ought to be done on a business basis. It does take time, but I hope that you can get it done more quickly.

Let me just say before we let you all go—and I apologize to you for being so long—we will keep the record open for questions. We hope you will answer these questions because this is an important hearing, and the questions that we ask are going to be very, very important with regard to what happens in the future.

I want to add that over the years I have heard from record companies, research companies, artists, and technology companies, and I want to see if there is anything we can do in Congress to help all of these parties in solving some of these problems, especially a number of important policy issues that, of course, have been raised by all of you. I think they are worthy, and they are ripe for consideration for this Committee.

Many of these center on enhanced protections for copyright while improving the respect we have for artists. Now, the issues that I think both Senator Leahy and I would like to throw out to you as a consideration for you to help us with are as follows—or at least these are some of them:

Number one, the public policy of limiting artists' personal service contracts. This is the issue raised in the Courtney Love litigation under California law.

Number two, how we can ensure that the current fair-use rights we enjoy, such as making personal copies of a CD on your own hard drive or in your home, could co-exist with digital rights protection technologies.

Number three, how we can provide for enhanced technological protections such as the recognition of watermark technology used by copyright owners when they provide their works over the Internet.

Number four, how we can resolve these work-for-hire problems and issues that have been raised here today before we get to acrimonious litigation between the artists and the record labels.

Number five, the collection and accounting of digital royalty rights, which appears to be a big problem here. We have to resolve that.

Number six, one issue of fairness that I have heard lots about, which involves the ownership of Internet domain names that correspond to the personal names of artists. Why should people steal artists' names and then want to charge you to use your own name? That is ridiculous, as far as I am concerned, but I would like your advice on that. I would like to hear from all the interested parties how we can help resolve some of these issues and further the creativity of our society.

Well, let me just say this has been a marvelous panel, and I know a lot of you have really sacrificed to be here. It means a lot to us, and I personally apologize for going so long, and I apologize to the next panel for it going so long. But it has been important, and we will continue to hold hearings that may elucidate what needs to be talked about in these areas.

With that, we will recess—

Senator LEAHY. May I just—

Chairman HATCH. Senator Leahy?

Senator LEAHY. I just want to say, Mr. Chairman, there are a number of these important issues. I think what Mr. Kearby said struck me. He wants to make the tools, not the rules, to paraphrase what he said. And I am not sure any of us on this panel would be prepared to, even if we could pass all the laws we wanted today in a fast-changing world like this, who knows just what to do. I don't have any doubt that when you speak about the tools, these can be done. Whatever kind of business model you want, any way of distribution you can do. And I suspect that we are going to find more and more consumer uses of that, whether it is down to something like this monitor and this mouse carrying all your records and everything else.

But Mr. Henley points out, I think very well, that it is one thing if you have a starting artist who wants to give away as a promotion music, that is fine. They do it in a lot of things. They do it with ice cream. Ben and Jerry's did it when they first started out. But then they became a multi-million-dollar business once people got used to it. Even well-established artists, Mr. Henley and Ms. Morissette, if they have a new album out, maybe they want to direct market it, assuming they don't have contractual obligations;

otherwise, they may want to give it away. Well, that should be their choice. But otherwise they should always be compensated. I mean, that is the thing we have to find out.

I think there is great genius in Napster and MP3 and all the other technical applications for the Internet that have been done.

As one who feels very strongly about our copyright laws, as one who looks even back to the beginning of this country and the Constitution when we talk about such issues, I want to make sure artists are protected. Otherwise, we are not going to have anything in the future. My friend from Utah has raised some points that are going to open up in some ways a Pandora's box, but I think it is not all that bad that we open it.

Chairman HATCH. Thank you, Senator.

With that, we want to thank you. We are going to take a five minute-recess. We would like to come out and shake hands with you while we set up the other panel.

[The Committee stood in recess from 12:55 p.m. to 1:06 p.m.]

Chairman HATCH. We are privileged on this next panel to have Congressman Chris Cannon, my dear colleague from Utah who is very familiar with Internet matters.

Then we will hear from Robin Richards, who is President of MP3.com, a leading Internet music distributor.

Ed Murphy is President and CEO of the National Music Publishers' Association.

Mike Farrace is Senior Vice President at Tower Records, a leading online and brick-and-mortar music retailer.

Sally Greenberg is Senior Product Counsel of Consumers Union.

Finally, Edmund Fish is President of the MetaTrust Utility Division of InterTrust Technologies, a provider of technological protections for copyright content online.

We look forward to your presentations today. We are really out of time, and I don't want to short-change you, but I would like you to summarize as best you can. If you can do it in less than 5 minutes, we would appreciate it.

We are going to reserve questions on the part of the Committee so that we can submit those in writing to you because this panel, in particular, should give us the best you can in writing as to what should be done about some of these issues.

So with that, we will turn to you, Mr. Cannon, and we appreciate your patience in waiting. We appreciate all of you for being patient in waiting this long.

**STATEMENTS OF HON. CHRIS CANNON, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF UTAH**

Representative CANNON. Mr. Chairman and Senator Leahy. I thank you for the opportunity to offer some thoughts on the issue of digital music and copyright.

Let me start off by saying that, as a conservative, I believe in and respect property rights, whether the property in question is physical, personal, or intellectual. Around the globe, people read books written by American authors, watch movies created by American directors, and listen to songs performed by American artists, all because we as a Nation respect creativity and provide a legal framework that encourages it.

As such, I cannot and will not support anyone who profits off other people's creativity or innovation and fails to compensate the creator. However, facilitating public access to creative works is also a key goal, one that in no way is inconsistent with Congress providing incentives for creativity. With that thought in mind, I would like to specifically address the marketplace for digital music distribution.

As you know, I have experience as a venture capitalist, starting more than a decade ago with Utah-based Geneva Steel. As e-commerce has taken hold, I have moved the focus of my efforts to technology. Like most venture capitalists, I have watched companies such as musicmaker.com and others that had hoped to distribute music via the Internet go out of business.

To be sure, the failure of online music distribution to take hold is in part rooted in the immaturity of the marketplace and the lack of residential broadband access. But there are also troubling signs that the recording industry may have intentionally chosen not to license music to new entrants to the marketplace.

It has been suggested by a number of observers that the industry may be manipulating copyright law to deprive the digital music market of competitive forces. If that charge is proven, the copyright model that the recording labels have come to rely upon will almost certainly require adjustment.

Any system of distribution that increases cost to consumers, decreases choices, or distorts the market should be thoroughly examined, particularly when that system exists only as an outgrowth of rights to intellectual property conferred by Congress.

We all know that Congress' historical approach to copyright law has not been static. Copyright protection is not a black-and-white issue. From player pianos to satellite television, we have been willing to modify copyright to meet blockages in the marketplace.

Whether the problem of digital music requires modification has yet to be determined. But I would hope Congress would not shy away from an examination of the issues merely because the same copyright stakeholders who sought from us the sweeping changes of the Digital Millennium Copyright Act 2 years ago now demand the absolute rigidity of the status quo.

Clearly, everyone here would prefer a market-driven solution to the issue. Yesterday's announcement regarding the industry's new deal with RealNetworks is a step in the right direction. However, the fact that the new distribution service will be 60-percent owned by recording labels highlights the potential dangers of vertical integration in the marketplace. If anti-competitive practices are taking place, we must be prepared to shift our paradigm regarding copyright licensing to ensure a vibrant and competitive market for on-line music.

The Internet continues to bring us wonderful, new developments, from entertainment to telemedicine. My hope is that as a result of vigorous competition among digital media companies, we will see a decline in the cost of digital music and other information, and with it more options for artists and consumers.

Mr. Chairman, thank you for holding this hearing. I look forward to working with you and other members of this chamber and my colleagues in the House to ensure an appropriate balance between

protection of intellectual property rights and the need for efficient distribution of information in the digital world.

Thank you.

Chairman HATCH. Well, thank you, Mr. Cannon. We will excuse you because we know you have other duties, but we appreciate having the benefit of your experience.

Representative CANNON. Thank you.

Chairman HATCH. Mr. Richards, we will turn to you.

STATEMENT OF ROBIN RICHARDS, PRESIDENT, MP3.COM, INC.

Mr. RICHARDS. Good afternoon, Mr. Chairman and Mr. Leahy. Thank you for having me here today to testify.

I heard a lot of compelling issues, I heard a lot of confusing issues. Some folks needed licenses and some folks wanted better security. Artists wanted to be paid for their works, as they rightfully should when they go on the Net, and consumers want their music in digital formats.

I hear the new service that is coming; keyword: it is coming. I look at MP3.com and I look at where we have been. I am here to request your help because we have licenses. We have security that the publishing companies and record companies have approved. We have collection and accounting systems where we can account for all of the listens. We have 28 million users, according to Media Metric's newest survey. We pay artists and writers every time somebody listens to their songs.

But the law is holding us back, and I am here to request your help in clarifying existing copyright law to ensure that the millions of Americans who have purchased CDs—and we need to make sure we talk about purchased CDs versus free music on the Internet or not purchased CDs—Americans who have purchased CDs be allowed to access them online whenever and wherever they want.

Last September, our company's CEO appeared before this Committee and described our innovative online music service and the disputes we found ourselves in with the music industry over the virtual music lockers we had created for consumers so that they could use the Internet to play back the CDs that they buy from the brick-and-mortar and online retail establishments.

Since that time, MP3.com has paid tens of millions of dollars to the five major record labels in the Harry Fox Agency, which claims to represent over 25,000 music publishers. Yet, after trying for nearly 6 months, we still aren't able to provide our listeners with access to the nearly two-thirds of the songs on CDs that they have purchased in the locker system.

So what is causing this problem and what can be done about it? The problem we are facing in giving consumers access to music online—and it is a problem that will be faced by every Internet music provider, AOL Time Warner and Real, as well; we are just a little bit ahead of them—is that there is no practical way for us to get licenses from all the music publishers with copyright ownership claims on the more than 900,000 songs in our digital library.

Dealing with this problem will require Congressional action. But while Congress considers that action, we need a more immediate fix—the establishment of a safe harbor under the auspices of the Copyright Office that will allow businesses like ours to begin bring-

ing music consumers the benefits that online technology offers, while protecting the interests of copyright owners. There is no contractual dispute between Ed and me; we are doing fine.

Obtaining licenses for every song would be a monumental task even if the publishing information were readily available, but it is not. Even for brand new CDs, it can take up to 2 months to track down who the publishers are. Mr. Murphy doesn't have that information.

More importantly, because the Harry Fox Agency doesn't represent every music publisher—the last estimate was 70 percent—and because many songs have several different publishers—some of our new music, hip-hop and rap, can have 10 publishers on one song claiming a share of the rights there—it appears that there is no practical way for us to get the clearances we need through the marketplace.

Nobody wants to buy a CD with 15 songs and find out that they can only listen to 4 or 5 of them, but that is the situation we find ourselves in. The good news is that the reproduction and distribution rights we need to get from the publishers already are subject to statutory compulsory license under Section 115 of the Copyright Act. It is here already.

The bad news is that its statutory licensing mechanism which dates back nearly 100 years is badly out of date. Even though Section 115 was amended in 1995 to extend it to certain online activities, the Copyright Office has never established royalty rates for a service like ours.

Moreover, the procedures that the Office traditionally has used in granting statutory licenses are cumbersome, time-consuming, and expensive. We actually would have to manually search the Copyright Office's records for the names and addresses of the copyright owners of each of the hundreds of thousands of song titles on the CDs that our consumers have purchased and stored online. And we would have to submit a separate application to the Copyright Office for each song whose current owners could not be located. That is thousands of folks we can't find. Using this antiquated system for obtaining licenses in a digital era would completely overwhelm the Copyright Office, which typically handles only a few hundred statutory license applications in a single year under 115.

In short, our problem in getting licenses isn't contractual nature, and the free market can't help. Our problem is that the marketplace and statutory licensing mechanisms that were developed in the pre-digital era simply cannot handle the demands of the Internet-fueled digital music economy.

People don't want to use the Internet to store and listen to some of their music purchases. They want all of the music they own to be available online to them, and this makes sense and seems right. We have built a system that can allow people to get the added value from their music purchases that the Internet promises. We and other innovators who will follow surely in our footsteps can make it possible for your children to leave their CD collections safely at home when they go off to college, or for you to listen to any of your CDs in your car or on a hand-held device without toting around suitcases full of silver discs.

To do these things, we need your help. Consumers need to know exactly what they can do with their music purchases, not just what they can't do. And we need Congress to reform and modernize the Section 115 compulsory license. We urge you to look to the model of the satellite and cable compulsory licenses which permit copyright users to submit periodic royalty payments into a pool that is then distributed among copyright owner claimants. This model gives the users of copyrighted works assurance that they have the protection of a compulsory license even if they cannot identify in advance every person who might claim an ownership interest in the works being used.

But most importantly, we need for Congress to encourage the Copyright Office to create an immediate safe harbor that will allow companies like ours to have the protection of a compulsory license while waiting for Congress and the Office to establish rates and update the procedures for getting those licenses.

We have shown that we are willing to pay copyright owners for licenses. We ask your assistance in overcoming the inadequacies of the current law and the system and marketplace and the statutory mechanisms for obtaining those licenses so that true competition can exist and music online can finally emerge.

I thank you for your time.

[The prepared statement of Mr. Richards follows:]

STATEMENT OF ROBIN RICHARDS, PRESIDENT, MP3.COM, INC.

Thank you for this opportunity to appear before you this morning. My goal today is to describe to you some of the hurdles faced by the developers of on-line music technologies in obtaining all of the licenses that the record labels and music publishers insist are necessary before consumers can take advantage of those technologies—even technologies that simply allow consumers to listen to the CDs that they purchase from brick and mortar and on-line retail establishments. In particular, I want to focus on the problems that Internet-music services such as ours face in meeting the music publishers' insistence that we obtain licenses covering the incidental reproductions that are inherent in enabling consumers to listen to their CDs in MP3 format. And, finally, I will describe an easily implemented "safe harbor" proposal that would allow the purchasers of recorded music to begin taking immediate advantage of some of the benefits that on-line music technology offers them while government and industry attempt to resolve larger questions regarding the application of the copyright law in the digital environment.

I appear before you as part of a new industry—an industry that represents a new economy in the throws of tumultuous transition. I don't think it is an exaggeration to say its future—the jobs it generates, the consumers it serves and the value it brings to artists and creators—is greatly dependent upon your actions.

The Internet music industry is at a critical juncture. The Wall Street Journal just three weeks ago put the problem in perspective. The Journal said, and I quote: "The music labels are asking lawmakers to stay out of the digital-music fight while they roll out their own competing online services, and, so far, it is working." The article went on to say that Congress is not ready to intervene. "Instead," the article said, "lawmakers plan to keep a spotlight on the issue by holding hearings and publicly urging the labels to move ahead quickly on their own services."

If this, indeed, is the position of Congress, then Congress is doing what it has seldom done, taking the side of one segment of an industry against another. This is not merely a matter of Congress allowing the marketplace to work out its problems. The stark reality is that Congress is taking the side of Goliaths against David. Congressional inaction will, in fact, give the music industry conglomerates that control both the sound recording copyright and the copyright in the individual songs on those recordings time to snuff out the competing small businesses attempting to emerge in the on-line music service sector. There will be no competition, except among these conglomerates themselves, who eventually will effectively control the music industry from one end of the spectrum to the other.

If that sounds alarmist, it should. Let me explain why.

We are a premier, worldwide, Internet music service provider. We give up-and-coming musicians access to a market and marketing that would otherwise be closed to them. We assist new entrepreneurs to use the management tools we've developed and refined to create their own services and businesses. We team with radio stations to bring the music of their local artists to on-line listeners. We provide unique music and management services to retailers. We sell CDs, recommend and assist with hardware and software, and provide free musical greeting cards. We have a children's channel, too.

I want to focus on just one of our services. In January 2000, we launched a service called My.MP3.com. My.MP3.com is a digital music storage "locker" service that uses MP3 compression technology to enable people to use Internet connected devices to listen to the CDs that they purchase at their local record store or from on-line retailers such as junglejeff.com and, in the near future, towerrecords.com. Today, the primary playback device for My.MP3.com users is their personal computer. But in the not too distant future, consumers will be able to use My.MP3.com to access their purchased CD collections using hand-held Internet-enabled devices and Internet-connected devices installed in their cars.

The way the My.MP3.com service works is as follows: with respect to a CD that a consumer already has purchased, the consumer takes the CD and places it in the CDROM tray of his or her computer; our "Beam-It" software then "reads" the CD and, having established that it is a real, legitimate CD release, adds the CD to a secure, personalized "locker" which can be accessed by that consumer—and only by that consumer. With respect to CDs purchased on-line from one of our retail partners, the consumer can use our "Instant Listening" software to add a CD in MP3 format to his or her personal locker at the same time the consumer pays one of our on-line retail partners for the CD, thereby allowing access to the songs on the CD even before the disc is physically delivered.

I want to emphasize that My.MP3.com differs from music file-sharing or "swapping" services that allow users to download, save, and trade music that they have not purchased. CDs can be accessed on My.MP3.com only for a real-time listening experience, not for downloading and copying. And before any CD can be accessed on our service that CD will have been purchased twice: once by the listener and, as discussed below, once by us.

As you know, not long after launching the My.MP3.com service, we were sued for copyright infringement both by the major record labels and by certain music publishers. The problem that we faced in trying to defend ourselves against these lawsuits is that the Copyright Act never anticipated the development of a technology such as My.MP3.com. While Congress has made certain changes to the Copyright Act in effort to address the use of digital transmission technology to deliver music to consumers, these changes rightfully focused on concerns that "on-demand" services that allowed consumers to choose what music they received over the Internet could lead to the widespread production and distribution of perfect "pirate" copies of sound recordings. Congress never foresaw—or addressed—the development of an "on-demand" service such as My.MP3.com—a service that poses no piracy threat since users can only "demand" music that they already have purchased and only for the purpose of receiving what essentially is a "private" performance via real-time, streaming audio, without the ability to duplicate, save, or share the transmissions.

Because Congress never foresaw the development of a personal purchased music "locker" service like My.MP3.com, the door was left open for record labels and music publishers to argue that My.MP3.com was infringing their copyrights by allowing consumers to access their purchased CDs in MP3 format. In particular, the copyright owners cited the fact that instead of developing a system that requires consumers to convert their own CDs into the MP3 format, My.MP3.com went out into the marketplace and bought those same CDs and converted them for the consumer. According to the record labels and music publishers, the act of converting these CDs to MP3 format, so that consumers who had separately purchased those same CDs could listen them to in that format, constituted an act of infringement. In addition, the music publishers took note of the fact that when a consumer listens to a song from his or her My.MP3.com locker, that song is delivered to the consumer by means of a "streaming" audio technology that automatically makes a temporary or "buffer" copy of a portion of the song as a necessary and integral part of the transmission process. Although this buffer copy lasts only a few seconds and is eliminated once the playback of the song begins, the music publishers asserted that, in order to use this technology to playback a CD to a consumer who has purchased that CD, My.MP3.com needed a separate license to make and distribute copies of the song.

In response to these lawsuits, we voluntarily "shut down" the My.MP3.com service and entered into settlement negotiations with various copyright owners and their

representatives. Shutting down our service deprived consumers of the ability to access the music that they had purchased and stored in their on-line lockers. There is a certain irony in the fact that by forcing us to shut down our site, the record labels and music publishers undoubtedly drove many of our customers to services such as Napster, where they not only could find and play the CDs that they already had bought, but also could (and probably did) obtain access to a vast array of music selections without ever having to purchase them.

In any event, although we disagreed with the interpretation of the copyright law put forward by the record labels and publishers, our desire to get our service back up and running led us to enter into very costly agreements covering all of their claims. We have agreed to pay for converting the CDs that we purchase into MP3 format. We have agreed to pay for performing both the sound recordings and the songs contained on those CDs.

And we even have agreed to pay the publishers for the temporary, momentary “buffer” copy that automatically is made (and deleted) each time someone listens to their own music out of their My.MP3.com locker. Yet, today, nearly six months after signing the last of these agreements, we haven’t been able to obtain all of the licenses that the copyright owners insist we must have before we can fully relaunch the My.MP3.com service.

Despite what you may hear from some of the copyright owners, our inability to obtain the necessary licenses is not merely a contractual problem that can and will be solved by the marketplace. Rather, it is a reflection of the fact that the existing marketplace and statutory music licensing mechanisms—mechanisms that developed nearly 100 years ago—simply do not work in the digital environment. As a matter of public policy, it is incumbent on government to address the failure of these marketplace and statutory mechanisms, both through immediate remedial action and through a comprehensive reassessment of the application of the copyright law to digital music technologies.

The particular marketplace and statutory failure that is currently frustrating our ability to provide the My.MP3.com service to consumers involves the licensing of the right to reproduce and distribute musical compositions, by means of streaming MP3 transmissions, to consumers who have bought the CDs on which those compositions appear. As I have indicated, we do not agree that the essentially “private” performances facilitated by our technology should trigger any additional copyright payments (over and above the compensation received by copyright owners as a result of the purchase of their works by us and by users of our service). Nonetheless, faced with a threatened onslaught of litigation, we agreed to pay the music publishers for making an “incidental digital phonorecord delivery” each time someone uses the My.MP3.com service to listen to one of their own CDs.

Incidental digital phonorecord deliveries—IDPDs for short—are a type of “mechanical” reproduction and distribution requiring licenses from the owners of the publishing rights in the songs contained on a CD. Our licensing agreement was made with the Harry Fox Agency (“HFA”), an arm of the National Music Publishers Association that, for nearly 75 years, has served as the music publishing industry’s principal clearinghouse for the administration of mechanical rights licenses. According to its website, HFA issues licenses, collects and distributes royalty payments, and audits the books and records of licensees on behalf of more than 25,000 music publishers who, in turn, represent the interests of over 150,000 songwriters.

When MP3.com and HFA announced their licensing agreement last October, the joint press release proclaimed that the deal was intended to give us licenses for over a million songs. And, in fact, we immediately provided HFA with a list of over 900,000 song titles, along with information identifying the CD on which each song appeared and the name of the artist performing the song, exactly as was requested by HFA. Six months later, however, HFA still has not been able to issue licenses to us for nearly two-thirds of these songs.

We are not suggesting that HFA hasn’t tried to clear the rights to more songs. Rather, the problem appears to be that HFA’s system for issuing mechanical rights licenses for its publisher members simply cannot handle the demands of the digital marketplace. In order for us to obtain a license for a particular song from HFA, we not only have to provide them with the song title, CD and artist, but we also have to know who owns the publishing rights for the song. This information is not readily available to the public and, to date, HFA has been unable or unwilling to match our list of song titles with their database of the songs published by their publisher-clients or to otherwise make available to us the information that they insist be provided on each license request.

Nor is this problem limited to the songs on “older” CDs. Making newly released CDs available to consumers through the “Instant Listening” option is one of the key attractions of the My.MP3.com service—and is something that helps promote the

sale of music. (For example, before we shut down the My.MP3.com service, participating retailers who offered their customers our Instant Listening option saw their sales of new releases as much as double.) But even after settling with the labels and publishers, we have been stymied in obtaining licenses for the songs on newly issued CDs.

A good illustration (reflected in the attached Exhibit 1) is our experience with the new Jennifer Lopez CD, "J-Lo." Shortly after Epic/Sony records released this CD, we attempted to make it available on My.MP3.com. We had obtained the necessary rights from the record labels with respect to the sound recording copyright and we had agreements with ASCAP and BMI giving us the right to "publicly perform" the songs on the CD. However, we couldn't get HFA to give us the required (by them) license for any of the songs. When we asked HFA why the songs on this new CD were not in their database and, thus, licensable, we were told that HFA would be able to issue licenses covering some—but not necessarily all—of the songs, but that it would take 6-8 weeks after receipt of a license request for HFA to locate the publishers associated with each song and get clearance. That's 6 to 8 weeks for just one CD. Consequently, we have been unable to offer consumers who buy the J-Lo CD from one of our on-line retail partners the opportunity to use "Instant Listening" to begin listening to their purchase while waiting for the physical disc to be shipped to their homes. Similarly, even after the customer has the actual CD in hand, he or she cannot use the Beam It software to add the songs on the CD to his or her My.MP3.com locker.

Apart from the problem of obtaining information matching up the songs we want to play with the songs owned by publishers represented by HFA, the difficulties we face in getting the My.MP3.com service back up and running are exacerbated by the fact that HFA does not represent every publisher and by the fact that the publishing rights in many, if not most song titles are held by multiple owners in varying percentages. For example, if you look at the liner notes of a "rap" CD—one of the most popular genres of music on-line, you will see as many as *ten* publishers on any given song. Many of these publishers may be impossible to locate or are otherwise unreachable.

Thus, even if HFA granted us licenses to the song catalogs of all of the publishers that they represent, there will be songs in My.MP3.com lockers for which we do not have clearance, or for which we have only a partial clearance. Indeed, we have already encountered the situation where, after activating a song in reliance on an HFA-issued license, we received notice from a non-HFA affiliated publisher claiming a partial ownership interest in the song and objecting to its being made available on our service.

In short, there is no marketplace mechanism that will allow us to fully relaunch My.MP3.com—thereby giving consumers access to all of the songs on all of the CDs that they have purchased and stored on their My.MP3.com lockers—without running a significant risk that we will be sued by unknown publishers claiming ownership rights in some of those songs.

Given the potential unavailability of marketplace licenses for any number of songs, the obvious solution is the establishment of a statutory licensing mechanism. And, in fact, nearly a hundred years ago, Congress addressed concerns that the withholding of music licenses could lead to the emergence of "a great music monopoly" by establishing a statutory compulsory copyright license for anyone who wants to reproduce and distribute copies of a previously licensed—*which originally applied to the reproduction and distribution of songs in mechanical formats such as piano rolls—to cover the digital delivery of reproductions of songs (including IDPDs), neither the statutory procedures for invoking the compulsory license, nor the Copyright Office's implementing regulations, have been adopted to meet the demands of the on-line music environment.*

A more detailed synopsis of the workings of the statutory mechanical copyright license (currently codified in Section 115 of the Copyright Act) is attached as Exhibit 2 to this testimony. Suffice it to say here that before MP3.com could claim protection under the statutory license, we would have to manually search the Copyright Office's records for the names and addresses of the copyright owners of every one of the nearly one million songs on the My.MP3.com service—a task that in and of itself is economically and practically infeasible. Moreover, for any song that does not have current ownership information on file, MP3.com (or any other on-line music provider seeking a compulsory license to a wide spectrum of musical works) would have to file a separate compulsory license application. This means that if current information is not available for merely a third of the million songs searched—a not improbable result given the songwriters and publishers are not required to notify the Copyright Office about changes in the ownership of a song's publishing rights, or even to register the copyright in the song in the first place—over 300,000

separate filings would have to be made at the Copyright Office. To put the burden that this would create in some perspective, last year the Copyright Office processed roughly 350 Section 115 license applications.

Congree cannot stand idly by and simply hope that the gridlock currently frustrating the relaunch of MY.MP3.com (which will frustrate the introduction of other services as well) will resolve itself. Many of you probably have seen the ad on television in which a weary traveler stops at a remote establishment and is offered a choice of every song ever recorded in every format. We are supposed to be shocked at this unimaginable concept. But, given the advances in digital technology, the idea that every piece of recorded music could be available at the click of a mouse is not unimaginable at all. What does remain unimaginable, however, is that anyone could ever track down all of the copyright owners in every single song and get them to agree to license terms. If the “science fiction” depicted in that ad is to become “science fact,” government must deal decisively—and quickly—with some fundamental questions regarding the on-line use of music.

For example, the rights implicated by the use of streaming audio technology must be clarified. If streaming audio is being used simply to perform a musical work, should the owners of the copyright in that work have additional rights because the transmitting entity, in order to render this performance, must first convert the work to MP3 format and because the creation of temporary “buffer” copies are an inherent part of the streaming process? We note that the Copyright Office has initiated an inquiry to address this issue in response to petitions filed by our company and by the RIAA. We hope the Office is able to offer some much needed guidance. But if the Office is unable or unwilling to do so, we urge Congress to step in and address these matters in a prompt and timely fashion.

Once the scope of the rights implicated by the use of streaming audio technology are clarified, Congress must ensure that there is a practicable means of licensing those rights. In particular, if it is determined that the right to convert DCs to MP3 format and/or to make “buffer” copies requires a license from the music publishers, Congress must reform the Section 115 compulsory license so that it can be utilized in the digital environment. We urge Congress to look to the model of the satellite and cable compulsory licenses, which permit copyright users to submit periodic royalty payments into a pool that is then distributed amongst copyright owning claimants. This model gives the users of copyrighted works assurance that they have the protection of a compulsory license even if they cannot identify and locate every person who might claim a copyright interest in the works begin used.

Finally, Congress needs to address the rights of music purchasers. The public, quite frankly, is confused. At every turn the courts, applying statutory provisions that never contemplated the services to which they are being addressed, are telling consumers what they cannot do. It is time for government to step in and clarify what someone who purchases a CD can do. Specifically, Congress needs to address the following questions:

(1) *Can and should consumers be able to listen to their own purchased CDs on any digital device?* In 1992, Congress enacted the Audio Home Recording Act, which gave consumers the right to copy CDs to tapes. Now questions abound about consumers’ use of the next generation of technology, such as personal computers and MP3 players. Each new device or format raises a new the issue of what the law allows consumers to do with the music that they purchase.

It shouldn’t take a separate act of Congress to permit consumers to use a new gadget to listen to their music. Let’s clarify copyright law once and for all and give consumers the explicit right to convert their music CDs into other digital formats for the purpose of enjoying their purchases on any Internet-enabled device.

(2) *Can and should music buyers be allowed to store their music in places where they can most easily access it?* One of the benefits offered by digital technology is that it can make music fully portable. No more lugging around CDs in order to have your music collection at your fingertips. Imagine being able to access all of your music purchases from your PDA, phone, car or wherever you happen to be. This is becoming more of a reality every day as the world around us goes on-line.

Unfortunately, the drafters of the Copyright Act never contemplated this situation so it’s subject to extensive legal debate. Music buyers should be rewarded with the maximum use of the music that they purchase with their hard-earned dollars. Let’s ensure that they have the rights to house their music purchases in places where they can best access it. And let’s encourage companies that build technologies to help them to do this faster or better.

(3) *Should CD buyers be subject to additional fees when they store and playback their purchased music collections?* If you buy a Ford, do you expect you can drive it anywhere without having to pay Ford more money? If you buy a paperback best seller, would you be surprised to be billed more money based on where you read

it? Can you think of any product you purchase outright, only to be surprised with additional charges in the future? In some instances, there could be fraud charges for selling something and then hitting the unsuspecting purchaser with more charges.

Yet this seems to be where we are headed with music CDs. Consumers believe they are buying CDs, but copyright owners argue that, under current law, payments can be imposed on a consumer's use of on-line technologies that allow them to store and playback the music that they have already bought. Is a consumer truly buying a CD or is it just a lease they'll have to continue paying on forever? Music buyers have the right to demand clarity in this area. Either CDs should be properly labeled as a lease and future payments defined in advance, or consumers should be only charged once no matter how or where they listen to their music. This is essential for them to make informed buying choices.

Last year we supported a bill, the Music Owners' Listening Rights Act, which addressed many of the questions posed above. We believe that the approach taken in that legislation offered an appropriate resolution of the rights of consumer with respect to the on-line storage and playback of their purchased CDs. However, we are not wedded to a single approach and look forward to working with Congress, the Copyright Office, and the music industry to clarify and confirm the rights of music consumers in the digital environment.

While we believe that there is a pressing need for quick action to clarify and reform the process by which on-line uses of music are licensed (to the extent licensing is necessary), we are not naive. We recognize that the questions that we have posed will not be answered overnight. Fortunately, there is a short-term solution available that will give My.MP3.com and other similar on-line digital music providers a "safe harbor" from infringement claims while protecting the music publishers' interests. Although Congress extended the Section 115 compulsory license to "IDPDs" in 1995, the Copyright Office has never adopted rules setting the rates or terms for invoking that license. In fact, the Office has expressly adopted a rule "the adoption of such rates and terms.

It is simply not right for the benefits of a statutory compulsory license enacted by Congress to be denied to on-line music providers because no rates or terms have been established for its use. We urge that you support our efforts to get the Copyright Office to establish a safe harbor mechanism whereby on-line music users can, by filing informational statements at the Copyright Office, obtain the protection from liability that compulsory licensing is intended to give. These statements would include the names of the songs for which protection is sought, together with information regarding the name of the CD on which the song appears, the artist performing the song, and the number of times that the song has been "delivered" to consumers. Once rates and terms have been established, royalty payments covering the activities described can be made.

This safe harbor approach, if implemented, will immediately solve the problem faced by MY.MP3.com and other on-line music providers: the risk of being sued for using songs owned by publishers who cannot be identified through the existing marketplace and statutory licensing mechanisms. More importantly, it will allow consumers to take advantage of innovative technologies that increase the value of their purchased CDs through on-line storage and playback. Put simply, as soon as this safe harbor approach is implemented, we will provide the required information and by the next day we will be in a position to "unlock" all of the purchased music that users of the MY.MP3.com service have stored on-line.

In conclusion, I would like to return to my opening comments. I hope that the implication in the Wall Street Journal article was not correct. I hope that it is no Congress' intention to allow the major record labels and music publishing companies to buy time until they drive others and us from this market, a market we created, a market we nurtured, a market we served. Such inaction would have catastrophic consequences, create an unholy alliance between government and the conglomerates, and set a very bad precedent.

The confusion and uncertainty surrounding the application of current copyright law to new digital music services helps only the established music industry, which is seeking through vertical integration to control not only the publishing and sound recording rights, but also the avenues of music distribution. Innovative new companies such as ours languish in regulatory limbo, while the international music conglomerates have free reign and the time they need to duplicate services that we invented, we innovated, we financed, we marketed and we brought on line, with some of the technology we revolutionized.

The real losers will be consumers, who will be denied competitive choices they have every right to expect. Also lost to them will be the spirit of innovation, invention and entrepreneurship that brought them this new technology and new services

in the first place. It is that spirit that has served as the backbone of the American economy since the days of our founding. Small business drives our economy, not any looming international conglomerates that seek to control it.

I am grateful to the Committee for scheduling this hearing and offering me the opportunity to describe the difficulties that we face in bringing the benefits and value of on-line digital music storage and playback to the purchasers of recorded music. I hope this hearing is not a placeholder. I hope it does not end with Congress believing this is enough while the others take advantage of our situation. I hope you will use this hearing as a springboard to action and find the necessary balance between the rights of copyright owners and the rights of consumers.

Thank you.

INTERNET MUSIC AND THE SECTION 115 "MECHANICAL" LICENSE

I. THE SECTION 115 "MECHANICAL" LICENSE:

What is the "mechanical" license? The "mechanical" license, which was first enacted in 1909 to address concerns about the possible emergence of a "great music monopoly," and which now can be found in Section 115 of the Copyright Act, is a "compulsory" copyright license that allows anyone to record and distribute their own "cover" version of a previously published copyrighted "nondramatic musical work" (i.e., a song) without having to negotiate with the copyright owner for the right to do so. The Section 115 license also applies when copies are made and distributed of a pre-existing recording of a song; however, in order to reproduce and distribute copies of a pre-existing recording, an additional license (referred to as a "master recording license ") must be obtained from the record label that owns the copyright in the pre-existing recording. The rate for the mechanical license was initially set by Congress and is subject to periodic revision by a Copyright Arbitration Royalty Panel.

How do you obtain a "mechanical" license? Section 115 provides that, if the name and address of the copyright owner of a particular song can be identified from the Copyright Office's records, anyone wishing to exercise the statutory "mechanical" license to make and distribute copies of that song must serve a "notice of intent" on the copyright owner prior to distributing any copies; failure to serve this notice before distributing copies bars reliance on the mechanical license. The statute also requires the compulsory licensee to make monthly royalty payments to the copyright owner (based on the number of copies distributed) and to provide the copyright owner with CPA-certified annual statements of account. The statute directs the Copyright Office to prescribe, by regulation, the form, content, and other requirements regarding service and certification of the initial notice of intent and the monthly and annual statements.

If the name and/or address of the copyright owner cannot be ascertained from the registration or other public records of the Copyright Office, the notice of intent must be filed directly with the Office; in such cases, however, no royalties will be due until such time as the copyright owner has identified itself in the Office's public records.

The Copyright Office has declined to promulgate "official" forms for either the notice of intent or the royalty statements. Instead, the Office has prescribed a set of rather detailed and burdensome filing requirements. The most burdensome requirement is that a separate notice of intent must be filed for each song for which the license is claimed. In addition to information about the song itself, each notice must be signed by an officer of the licensee, must contain detailed information about the licensee (e.g., the names of all of the officers and directors of any entity with a greater than 25% beneficial ownership interest in the licensee), and must be served on the copyright owner by registered or certified mail. For each notice that is filed with the Copyright Office (because the name/address of the copyright owner is not available), a \$12 filing fee must be paid; another \$8 fee must be paid if the licensee wants to receive an acknowledgement of the filing from the Office.

The role of the Harry Fox Agency. In practice, the statutory mechanical license process is rarely, if ever, utilized. Instead, mechanical rights licenses are granted (at the statutory royalty rate) by the Harry Fox Agency ("HFA "). According to its website (<http://www.nmpa.org/hfa.html>), HFA represents more than 22,000 U.S. music publishers. Songwriters (who are the original copyright owners of the songs they compose) typically assign their copyright interests to publishing companies. The process of applying to HFA for a mechanical license requires a separate application for each song; the information required by the application form includes the name(s) of the publishers who hold an interest in the song for which the license is being sought and the percentage ownership interest held by each publisher. The

HFA website indicates that it takes 4-8 weeks for a license to be granted if the application is submitted manually. When a song is released for the first time on CD, the labels and/or publishers don't always tell HFA; consequently, when an application for a mechanical license is filed for a new song, HFA may have to go back to the publisher for authorization to grant the statutory license:

II. THE PROBLEM OF LICENSING THE ON-LINE DISTRIBUTION OF MUSIC

In 1995, Congress sought to clarify the application of the "mechanical" compulsory license to the on-line distribution of music by amending Section 115 to specify that it covered digital transmission services that make "digital phonorecord deliveries." Notwithstanding this amendment, the ability of consumers to utilize Internet-based tools to enjoy recorded music continues to be frustrated by legal uncertainty over the scope of the Section 115 compulsory license and by the practical unmanageability of the current Section 115 process in an Internet environment. Furthermore, when it comes to the distribution of music on-line, neither the Harry Fox Agency nor the record labels can be relied upon as a surrogate for the statutory licensing process.

Legal uncertainty. The 1995 amendments to Section 115 provided for the establishment of royalty rates not only for "digital phonorecord deliveries," but also for "incidental digital phonorecord deliveries" ("IDPDs"). Unfortunately, the neither the Copyright Act nor the Copyright Office's rules define what constitutes an "IDPD." The music publishers argue that the temporary "buffer" or "RAM" copies typically made on a web-user's computer in order to receive a "streamed" real-time Internet performance of a song constitute IDPDs for which the transmitting entity must obtain mechanical licenses—separate from the licenses are needed to perform the song. Not surprisingly, streaming audio services, including digital locker services such as My.MP3.com disagree.

In addition to legal uncertainty as to what constitutes an IDPD, there is legal uncertainty as how the Section 115 license is to be applied with respect to IDPDs. The 1995 amendments directed the Copyright Office to conduct a rulemaking to establish such rates and terms; however, upon request of the songwriters and record companies, the Office "deferred" the adoption of IDPDs rates and terms—a decision that remains in effect today. The Office has never explained the meaning of its "deferral" decision. For example, if during the deferral period a transmission service does not file a "notice of intent" before making IDPDs of a particular song, does the service lose any right to rely on the mechanical compulsory license after the deferral is lifted? Are transmission services immune from liability for IDPDs made during the deferral period or will the rates adopted when the deferral is lifted apply retroactively?

Practical unmanageability. Even if there was no uncertainty as to what constitutes an IDPD or as to the significance of the Copyright Office's deferral of IDPD rates, the Copyright Act and the Copyright Office's rules erect insurmountable practical obstacles to the use of the license by Internet-based music providers who are deemed to be making IDPDs. The problem is that an on-line digital locker service such as My.MP3.com, which allows consumers to access streamed performances of their personal music collections on any Internet-enabled device, needs clearance for literally hundreds of thousands of song titles.

- As a prerequisite to obtaining a compulsory mechanical license under Section 115, MP3.com would have to manually search the Copyright Office's records for the name and address of the copyright owner for hundreds of thousands of song titles (or pay someone to conduct such a search).
- The Copyright Office currently charges \$65.00/hour to search its records (with an estimated time to conduct a search of between 8 and 12 weeks)
- It is likely that, for a substantial number of song titles (totally in the tens, if not hundreds, of thousands), the Copyright Office records will not reveal the name and/or address of the copyright owner. For each of these titles, MP3.com would have to submit to the Office a separately prepared and signed "notice of intent" along with a \$12 filing fee per notice.
- Even where the Office's records identify the name and address of the copyright owner, it is a virtual certainty that the records for thousands of songs will be out-of-date and that notices sent to the listed address will be returned as undeliverable; in such cases, MP3.com will have to file with the Copyright Office each returned notice, along with evidence of the attempted service.
- And, finally, as for the songs for which accurate addresses can be obtained, MP3.com will have to prepare and serve, via registered or certified mail, separate notices for each title, and will have to submit monthly payments and CPA-certified annual accounting statements for each title.

- In short, compliance with the current Section 115 procedures is not feasible, either practically or economically. And if MP3.com did try to follow the existing procedures, the Copyright Office would end up being buried in an avalanche of paper that it could never process.

On-line music distributors cannot rely on The Harry Fox Agency and/or the record labels as an alternative to the Section 115 compulsory license process. As noted above, distributors of recorded music traditionally have obtained mechanical licenses through the Harry Fox Agency rather than through the statutory processes established by Section 115 and the Copyright Office's rules. However, when it comes to on-line distribution of recorded music, neither the Harry Fox Agency, nor the record labels can be relied upon to provide a workable alternative to statutory licensing.

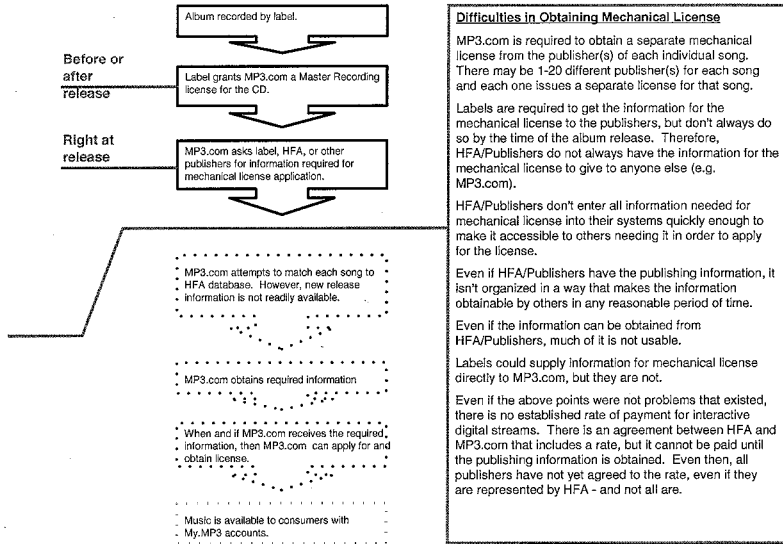
In October 2000, MP3.com, which had been accused of making unlawful digital phonorecord deliveries by certain music publishers, entered into a widely publicized settlement with those publishers and with the Harry Fox Agency. In the joint press release announcing the settlement, the publishers characterized the agreement as a "landmark proposal" that the Harry Fox Agency could "refer to the music publishing and songwriting community with confidence and enthusiasm."

More than five months later, the Harry Fox Agency has been able to give MP3.com mechanical licenses for only a fraction of the nearly one million song titles owned by its publisher-principals. Nor has MP3.com been able to obtain publishing information or clearances from the publishing subsidiaries of the major record labels, despite having entered into separate settlements with each of those labels.

CONCLUSION

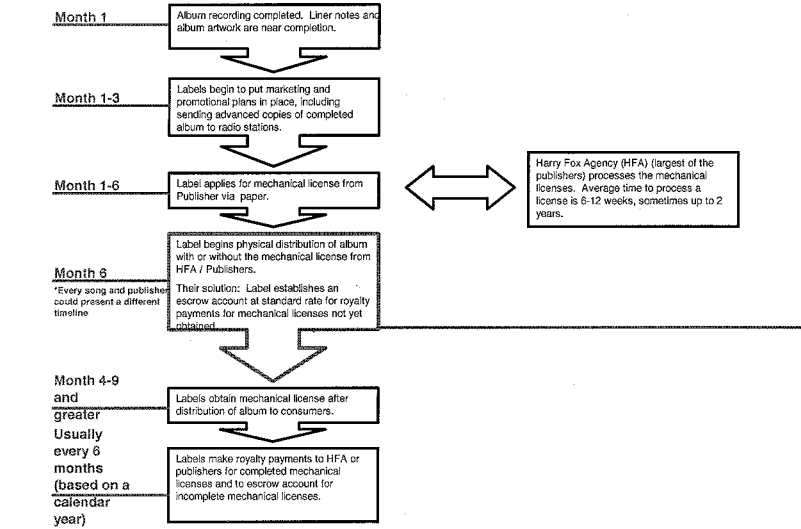
Given the unwillingness and/or inability of the publishers and the record labels to provide Internet music distributors with the mechanical rights that allegedly are necessary to operate their businesses—rights that are supposed to be subject to "compulsory" licensing—and given the practical impossibility of complying with the prerequisites for that "compulsory" license, it is clear that Congress must seriously consider major reform to Section 115 in order to ensure that the public is able to enjoy the benefits of innovative, on-line music technologies such as My.MP3.com.

The Way the Mechanical Licensing Process Works for MP3.com / Digital Distribution



February 9,

The Way the Mechanical Licensing Process Works for the Labels / Physical Distribution



Chairman HATCH. Thank you, Mr. Richards.
Mr. Murphy, we are glad to have you here.

**STATEMENT OF EDWARD P. MURPHY, PRESIDENT AND CHIEF
EXECUTIVE OFFICER, NATIONAL MUSIC PUBLISHERS' ASSO-
CIATION, INC.**

Mr. MURPHY. Thank you, Mr. Chairman, and thank you for your ongoing participation in efforts to help the creative community and the songwriters and publishers.

Mr. Chairman, you have asked whether online entertainment will be coming soon to a digital device near you. For music, the question is not whether it is coming; the music is here. Our members have licensed more than 30 enterprises, most of them fledgling businesses less than 5 years old, to distribute recordings of music over the Internet. Among them are eMusic, MP3.com, and MusicBank. These companies have chosen to respect the rules laid down by Congress by obtaining licenses and paying compensation to the copyright owners.

These licenses demonstrate that the music publishers are committed to licensing their music on the Internet, and confirm that Congress has provided us with sufficient flexibility to license new and innovative music services. In this connection, I understand that MP3.com has said here today that music publishers have not issued licenses under their settlement agreement. This is not totally correct. HFA has deemed MP3.com to hold interim licenses for virtually every song in our publishers' repertoire. This amounts to more than 600,000 songs that are available right now to be used by My.MP3.

NMPA and HFA have also agreed to extend these interim licensing agreements, and promised not to support any lawsuits against MP3.com while the parties hammer out the final details of processing individual license requests for each song that MP3.com wishes to make available on its service.

We are committed to devoting whatever resources are necessary to help MP3.com support proper licensing requests. The challenge is to put Humpty Dumpty back together again after the fact because, as you know, MP3.com did not follow the usual process of requesting licenses before making our songs available. MP3.com submitted more than 600,000 license requests at one time, and HFA typically processes about 250,000 licenses per year on behalf of the entire recording community. But this can be done and we are doing it.

Music publishers believe that users of music must compete in the marketplace on a level playing field by following the rules of the road. Congress clarified the rules of the road on the Internet by confirming in the Digital Performance Right in Sound Recordings Act of 1995 that songwriters and music publishers had exclusive rights to make digital phono deliveries. In doing so, Congress gave us the flexibility to license business models that no one could have anticipated 6 years ago.

Unfortunately, many Internet music services, most notably Napster and its imitators, are flaunting the rules established by Congress. By refusing to obtain licenses to pay copyright owners required by Congress, Napster and its imitators are placing our li-

licensees at a potential fatal competitive disadvantage. Many of our licensees are feeling the squeeze and are under intense financial pressure from Napster.

Mr. Chairman, the situation is frankly really outrageous. Businesses that respect the rules of the road should not be penalized because a few irresponsible parties ignore the speed limit. The music publishers' lawsuit against Napster is all about restoring a level playing field. We do not object to peer-to-peer technology, as such. However, our members do object to Napster's business practices.

Napster built services on the premise that music creators should provide content for free. It is teaching an entire generation that music has no value on the Internet. Two Federal courts have now concluded that Napster is facilitating copyright infringement on a scale that is without precedent.

While Napster has acted disreputably, those who seek to imitate Napster truly have no excuse. Now, Napster wants music creators and copyright owners to bear the expense of monitoring the Napster service. While many are quick to jump on the Napster bandwagon, if copyright owners are no longer to be compensated for their creative efforts, they must not bear such a burden. In the long run, far fewer songs will be written, and obviously we will all be the lesser for that.

Finally, in the wake of the Ninth Circuit decision, Napster here today suddenly sees compulsory licensing, whether established by Congress or the courts, as a solution. Compulsory licenses, however, were available to Napster for our members' songs before it launched its service. Napster simply did not avail itself of them. With due respect, Napster is being, I think, very disingenuous.

We remain cautiously optimistic that Napster will comply with the district court order. We look forward to working with Napster in this regard, and with MP3.com. It is conceivable that Napster will choose to comply with its obligations and obtain licenses, but we are not there yet.

In sum, Mr. Chairman, laws passed by Congress continue to serve the intellectual property community, including music creators and music users alike. There is no need to fix, as we say, what ain't broke.

I thank the Committee for this opportunity to testify. I am happy to answer any questions in writing later. Thank you, Mr. Chairman.

[The prepared statement of Mr. Murphy follows:]

STATEMENT OF EDWARD P. MURPHY, PRESIDENT AND CHIEF EXECUTIVE OFFICER,
NATIONAL MUSIC PUBLISHERS' ASSOCIATION, INC.

Good morning, Mr. Chairman, Senator Leahy and members of the Committee. I am Edward P. Murphy, President and Chief Executive Officer of the National Music Publishers' Association ("NMPA"). On behalf of the more than 700 members of NMPA that own or control the majority of the musical compositions licensed for manufacture and distribution as phonorecords in the United States, I want to thank you for inviting me to testify today about music publishers' successful efforts to license their music on the Internet and to guarantee a level playing field for all of our licensees. Songwriters and music publishers have long been enthusiastic about the Internet's potential, and are working hard to get their music to the millions who log on to the Internet every day.

Nearly a century ago, a new technology emerged that changed the music industry forever. The new technology was the piano roll—essentially long perforated sheets

that operated a player piano's keys. One piano roll company attempted to acquire exclusive rights to virtually every musical composition. To make sure that musical compositions were widely available for reproduction as piano rolls and in other media and technologies, Congress enacted a compulsory license. A compulsory license means that once a sound recording of a copyrighted musical work is made and distributed with permission, anyone else can obtain a statutory license from the copyright owner.

The Harry Fox Agency, Inc. ("HFA ") was founded in 1927 and today operates as an industry service subsidiary of NMPA. HFA acts as agent for more than 27,000 music publishers in licensing their musical compositions for reproduction as CDs, cassette tapes, LPs and digital phonorecord deliveries, as well for use in motion pictures and other audiovisual productions. Over the years, Congress has repeatedly recognized and affirmed HFA's role in negotiating on behalf of its music publisher-principals. HFA is the place everyone knows they can go to get a license to make phonorecords. With HFA, songwriters and music publishers are poised to license music for use on the Internet.

Thanks to Congress, the rules of the road for the use of music on the Internet also have never been clearer. With passage of the Digital Performance Right in Sound Recordings Act of 1995, Congress confirmed the exclusive right of song owners to transmit (or authorize others to transmit) phonorecords of their works over the Internet known as digital phonorecord deliveries, or "DPDs." Congress expressly made DPDs subject to compulsory licensing in the same manner as CDs, cassettes and LPs. If a record label or Internet music company follows the rules of the road, the toll that must be paid is a fair and reasonable one: now just seven-and-a-half cents per download.

In that connection, Mr. Chairman, you have asked whether online entertainment will be "coming soon to a digital device near you." For music, the question is not whether it is coming—the music is here. Indeed, our members have licensed more than thirty enterprises, most of them fledgling businesses less than five years old, to distribute recordings of music over the Internet. Among them are Emusic and MP3.com and Musicbank. These companies have chosen to respect the rules laid down by Congress by obtaining licenses and paying compensation to the copyright owners. These licenses demonstrate that music publishers are fully prepared and poised to license any Internet music service if it observes the rules Congress has set.

Unfortunately, many Internet music services, most notably Napster and its imitators, have flouted the law that Congress enacted and are making a mockery of these rules. Two federal courts have now concluded that Napster is facilitating copyright infringement on a scale that is without precedent. And while Napster has acted disreputably, those who seek to imitate Napster in the wake of those decisions truly have no excuse. By refusing to obtain licenses and pay copyright owners as required by Congress, Napster and its imitators are placing music publishers' law-abiding licensees at a substantial competitive disadvantage. Many of our licensees are feeling the squeeze and are under intense financial pressure from Napster. Mr. Chairman, the situation is, frankly, outrageous. Why will anyone want to get a license, if that will only put the licensee at a potentially fatal competitive disadvantage? Businesses that respect the rules should not be penalized because a few irresponsible parties willfully ignore the speed limit.

The music publishers' lawsuit against Napster is about restoring a level playing field. We do not object to peer-to-peer technology as such; however, our members do object to Napster's parasitic business practices. Napster does not pay for content, bandwidth or storage for its music service. Napster claims that it has the right to make its shareholders Internet billionaires, but its service was built on the premise that music creators should provide the content that draws consumers to Napster's service for free. Now Napster wants music creators and copyright owners to bear the expense of monitoring the Napster service. While many are quick to jump on the Napster bandwagon, if copyright owners are no longer to be compensated for their creative efforts and must bear such burdens, in the long-run, far fewer songs will be written. Consumers will be the ultimate losers.

Remarkably, in the wake of the Ninth Circuit's affirmation of the District Court's issuance of a preliminary injunction, Napster now sees compulsory licenses whether established by Congress or the courts—as the solution. Songwriters and music publishers find this to be disingenuous because Napster chose to flout the rules prescribed by Congress for obtaining a compulsory license in the first place.

There are precedents, of course, where companies have ceased their infringement and moved to respect the rules established by Congress. The most notable, recent example is MP3.com. MP3.com copied tens of thousands of CDs and placed copies of the sound recording tracks on its computer servers to offer the MyMP3 inter-

active music service in January 2000 without first obtaining licenses. After litigation, the music publishers and MP3.com entered into a landmark settlement pursuant to the compulsory license provisions of the Copyright Act. The settlement provides for payment of compensation for past acts of copyright infringement and a forward-looking license for the MyMP3 service.

In this regard, MP3.com raises two issues relating to licensing musical compositions in connection with its MyMP3 service:

First, MP3.com has expressed its concern regarding the availability of a compulsory license for subscription music services because there is no current rate in effect. The compulsory license provisions specifically contemplate that owners of musical works will negotiate and reach private agreements as new business models arise. Pursuant to those provisions, MP3.com has obtained a license with specified rates. Representatives of the recording industry, the digital media companies and NMPA are currently exploring a range of options for licensing these types of services. If a resolution cannot be reached as to appropriate rates, Congress provided that such matters will be addressed by arbitration before a Copyright Arbitration Royalty Panel. If lower rates are agreed upon in a broader consensus or are determined by a Copyright Royalty Arbitration Panel and are adopted by regulation, MP3 will receive the benefit of those terms under the "most favored nation" provision in its settlement agreement with the music publishers, thus preserving a level playing field.

Second, MP3.com has expressed its concern over the difficulty it has encountered in preparing proper license requests. Accurate licensing information is necessary to make sure the proper copyright owner is paid for the use of its musical work and the legislative proposals suggested by MP3.com would not eliminate the need for accurate information. To help MP3.com identify the music MP3.com had already put on its service, HFA has provided MP3.com with an electronic copy of its licensing database, something HFA had never before provided to any record company or any other licensee. And NMPA and HFA have provided MP3 written assurance they will not support any litigation against the company while both work in good faith to address these problems.

Finally, we agree with MP3.com that HFA could better serve MP3.com and other music service providers if the lag time between the release of a new recording and the submission by the record company of its own license requests were substantially shortened. We will continue to work with MP3.com and with the record companies to make improvements in this area.

In sum, we believe that the compulsory license provisions already in existence for musical compositions are sufficiently flexible to address the new business models that crop up every day on the Internet. A level playing field, however, is essential so that Internet music services have every incentive to obtain licenses and compensate songwriters, and so companies that do so are not penalized for following the rules of the road.

I thank the Committee for this opportunity to testify.

Chairman HATCH. Thank you, Mr. Murphy.
Mr. Farrace?

**STATEMENT OF MIKE FARRACE, SENIOR VICE PRESIDENT,
DIGITAL BUSINESS, TOWER RECORDS/BOOKS/VIDEO, MTS. INC.**

Mr. FARRACE. Thank you, Mr. Chairman.

Along with its competitors, Tower Records plays an important role in assuring that the consumer benefits from vigorous competition in the marketing and sale of recording audio and video products. Right now, we think the law provides a good balance between copyrights and competition, but it may not in the future.

The law gives copyright owners incentive to create, but gives balance to the process by granting owners of copyrights broad rights to distribute those creations after the first sale. It is these checks and balances that keep competition keen. And as I will mention in a moment, if intellectual property owners had the right to control copyrights years ago the way they propose to do so now, there would be no used books, no lending your records to a friend, no video rentals, and no donations of recorded products, software, or even books to libraries or schools.

About 5 years ago, a friend sent me one digital song file which took me about 3 hours to download, but it was still one of the most exciting things I had ever done. A couple of years later, our company got T1 access and the resulting increase of download speed convinced me that we were on the threshold of the most incredible period in our history. The promise of instant access, portability like never before imagined, rich multi-media add-ons and all the rest was irresistible. This was the chance of a lifetime to provide our customers with the best possible experience.

We did download experiments with our record company partners, mostly free promotions. At the same time, we started working with new digital companies like Liquid Audio to build digital retailing tools and to integrate digital sound files into our business.

As a result, we can now add secure, watermarked digital files to an Internet shopping basket that contains physical goods like CDs or DVDs. We can accept virtually any form of payment. We can reconcile the charge, provide refunds, issue credits, replace defective merchandise—all the stuff retailers do. So we have a system that works.

We have been selling downloads for almost 4 years now, and though the technology continues to evolve and improve, the rocket science part is over. The members of the retail community know how to send a secure digital sound file safely and securely without running the customer through a gauntlet or invading their privacy.

We have made it clear to record companies that we are ready and willing to go into business with them. We have demonstrated that we are willing to work on solving any digital dilemmas, and they know we want to play by the rules. But quite honestly, we are puzzled by some of the rules which are unfriendly to customers and retailers.

Particularly worrisome is that some companies require individual personal data from the consumer in order to access the content. Virtually all the companies interrupt the transaction process in some way to gather customer information. Only one company does not, and none of the others will promise not to use this information to solicit our customers directly in the future.

So what is wrong with this picture? We market to and acquire the customer, then are forced to violate their privacy and damage our relationships, which are requirements just to get the merchandise we want to sell. So you may see why we are concerned.

We are a one hundred-percent permission-based company. We never send e-mails to our customers without their permission. So, naturally, we think requiring customers to submit their individual personal data to access a recording they are paying for or enticing them while we are trying to conduct business with them is unfair.

We have the same concerns about the rules our customers are being asked to agree to. These end user license agreements which aren't even seen by the customer until after they have paid for the music can be downright oppressive. Some have had outrageous restrictions written by lawyers who saw people as thieves instead of customers. And although we deal with our fair share of theft, this is not the way we choose to perceive our customers, nor is it the way we want them to perceive us.

These click-through agreements are awkward, confusing, and they create serious customer service issues for companies like Tower. It is like someone else is standing behind our cash register, free to create customer service policy on our behalf and even sell to our customers directly. We must control this relationship that we have spent so much time and energy and money cultivating and which is at the core of our commitment.

So these barriers to broad access lead us to question sometimes the motives of our suppliers. We worry that all this talk and activity about protecting the music is really about controlling lawful use and cutting retailers out of the marketplace.

The deals record companies are pursuing are with each other or with new or small companies that they may end up owning. They say they want us in this business, but they don't honor our privacy policies or make systems simple enough for users. Instead, Bertelsmann buys CDNow, which has a strategic relationship with Time Warner, which is trying to cross-license with Sony, which is building a subscription service with Universal, which has a joint venture with BMG. That is four out of the five major suppliers, and the fifth one, EMI, has been for sale all year. And similar announcements are coming from the movie studios.

Our suppliers have the right to get into retailing, and we recognize that and we are not afraid to compete with them. But it is not fair to let these companies use their power over us to steal the customers and ultimately steal our business. Retailers need rules that protect competition.

I am speaking just for Tower today, Mr. Chairman, but if you ask Pam Horvitz at NARM, which is the association that represents music retailers, or Bo Anderson at VSDA, which represents video retailers, they will tell you that all retailers just want a level playing field that lets them do the marketing and the selling, and I think that is what our Government wants also.

The bottom line, in conclusion, is that we are frustrated by the progress that has been made so far. We are sympathetic to the record companies' worries about piracy in cyberspace. We understand their fear of losing control of assets. We understand that this could endanger their profitable durable physical goods distribution system. Believe me, we understand that, too, but it is time to get out of each other's way a little and go to work.

I thank you for inviting me to testify today and I am happy to take any questions later. I have summarized this testimony here, but I have submitted the written testimony to be put in the record.

Chairman HATCH. Without objection, we will put all full statements in the record. That is for sure.

[The prepared statement of Mr. Farrace follows:]

STATEMENT OF MIKE FARRACE, SENIOR VICE PRESIDENT, DIGITAL BUSINESS, TOWER RECORDS/BOOKS/VIDEO, MTS., INC.

Good morning. My name is Mike Farrace, and, among other things, I'm responsible for digital business at Tower Records. Tower started out as a single store selling records in Sacramento, California in 1960. Today, we own and operate 189 stores in 17 countries not counting franchises, and we sell books and movies as well as music.

We're famous for a couple of things: great selection and knowing what we're talking about. Every record in stock and every kid roaming the sales floor represent investments in customer satisfaction. We stock an amazing variety of recordings, and

the people we employ are there because they love records. We open early, stay up late, make our stores beautiful and work our tails off to make music lovers happy.

We find out what people want, and we sell it to them the way they want it. Our stores have been in the thick of every musical revolution since 1960. We've managed at least 13 physical configurations of audio playback media and at least four video formats during that period. We've sold vinyl albums and 45s, Eight Tracks, Four Tracks, Reel to Reel, Cassettes, Compact Disks, Digital Compact Cassettes, MiniDiscs, CDR, Enhanced CD, CD ROMs Mini CDs and probably a few formats I've forgotten. We were the first U.S. music retailer in Japan, the first to publish our own magazine, and the first traditional reseller with an online record store. We were among the very first to embrace LaserDisk and later DVD. Sometimes these investments turn out to be great. Sometimes they don't. But we keep trying because that's what we do. We've never been shy.

We're where the record labels turn when they're trying to break new music, which is the hardest job of all. We've done many thousands of promotions in support of bands in almost every conceivable genre of recorded sound, including ones for Don Henley and Alanis Morissette. All the in-store performances, display contests we run, and crazy things we've asked our stores to do have helped sell a lot of records, and helped establish careers for these artists.

While, without a doubt, we are completely dependent on the artist and the customer for our livelihood, because of the way the record business works, we are also dependent on labels and distributors. We've had many battles over all kinds of things with our suppliers. We've gone toe to toe about terms and support. We've wrestled over more complex issues, like whether "12 CDs for a penny" record clubs are really fair play, or whether embedding a hyperlink on a CD, which is a couple of clicks from a reseller that isn't us, and is sometimes the supplier, isn't just a bit devious, and unfair.

Of course, the record companies could probably add a few pet peeves about us. But together, we manage. In the best of times, it's a privilege to be a partner in the chain to creative works that please so many people, and a pleasure to work with the people that create and distribute it.

We've been a good partner so far in the music industry, and we want to continue to be a good partner in the digital age.

Five years ago, someone I knew sent me a digital song file. I was convinced we were on the threshold of one of the most invigorating and fulfilling periods in retailing history. The promise of instant access, portability like we never imagined, rich multimedia add-ons and all the rest was irresistible. If our core values included giving the customer the best possible experience, this was the chance of a lifetime.

We started working with new digital companies, (one of which—Liquid Audio—is present here today), to integrate digital sound files into our physical goods systems. In the last five years, we've used over a dozen audio codecs and four digital rights management systems. We have seen at least a half-dozen secure bonafide digital delivery mechanisms and have implemented two.

As a result, we can add secure, watermarked digital files to a shopping basket containing physical goods and can accept a wide range of payment forms. We can provide samples on virtually every song in our database. We provide reports ranging from basic sales and traffic to incredibly detailed user behavior statistics where we have our customer's permission. We use digital special ordering and sampling in some stores and will continue to roll out even more services in the coming months. We have a system that works. We've been selling downloads for almost four years and while the technology continues to improve, the rocket science part is over. We've shown record companies that we're willing to work with them on digital distribution. The only thing missing is a big press conference to announce we have all the content.

So far we've had something around 100,000 downloads available for both sale or promotion from a handful of companies including Liquid Audio, EMI, Warner and Sony. But as a retailer, I don't think my digital offering is very attractive. First of all, there isn't much of a selection. There are tens of millions of songs available on compact disk around the world, and only a small percentage have been authorized for digital sale. Our Internet experience has taught us that selection equals sales. Our first online store in 1995 started with just 20,000 titles. All things being equal, sales increased consistently with selection. Today, towerrecords.com offers well over 500,000 titles—something like 5 million songs. We want the digital equivalent of that.

Second, the suppliers use disparate delivery systems, each one unique, requiring the download of special software and the use of a specific digital rights management provider. It's like requiring the retailer to have a different cash register for each distributor not to mention a plethora of separate steps and confirmation emails to

the unfortunate customer who actually wants multiple songs from more than one company.

We've always played by the rules, but today we're puzzled by the rules. Particularly worrisome is that some companies require personal data from our customers. They insist on actually possessing the names, and only a few will promise not to solicit these customers immediately or in the future. We're trying it, but we're worried about violating our own privacy policy, damaging our relationship with our customers, and maybe even result in Tower violating the law. Tower Records is a 100% permission-based company. We never send emails to our customers without their permission, and feel that either requiring customers to submit their personal data to access the recording or enticing them while we are conducting a transaction is unfair.

We have the same concerns about the rules our customers are being asked to agree to. First off, these End User License Agreements aren't even available to our customers until after they've bought the music. Some of the first ones we saw were pretty horrible, and had some outrageous restrictions that made customers feel like untrustworthy thieves. These "click through" agreements are very awkward and confusing to consumers and create service issues for resellers. This control over usage is enforced by technological locks that are the digital equivalent of preventing anyone from reading a book unless they make a payment to the copyright owner every time they open it. It's like having someone else standing behind our cash register, taking control of the customer relationship that we have cultivated, and which is core to our commitment.

The bottom line is that we're pretty frustrated by the progress that's been made so far. We're sympathetic to the record company worries about piracy in cyberspace. We understand their fear of losing control of assets. We think part is fear that it will endanger their profitable and durable physical goods distribution system. And believe me, we understand that too.

But many of the barriers that prevent access to an exhaustive inventory of sound are perplexing, and frankly, lead us to question the motives of our suppliers. We're starting to worry that maybe all the talk and activity about protecting the music is not just about controlling copyright infringement, but is really about controlling lawful use and hiding plans for cutting retailers out of the marketplace. A lot of the deals the record companies seem most interested in pursuing are with each other, or with companies that they all buy a piece of—like MusicNet. They tell us they want us in this business, but they don't follow up with products that we would want to sell or that our customers would want to buy. Instead, Bertelsman buys CDNow which has a strategic relationship with Time Warner which wants to cross license movies with Sony which has a subscription service project with Universal (called Duet) which has a joint venture called "GetMusic" with BMG. That's four out of five of my major music suppliers, and the fifth one, no offense to Ken Berry at EMI, has been for sale all year.

OK. My suppliers have the right to get into retailing. Tower isn't afraid to compete with retailers. We think we're pretty good. But we don't think it's fair to let these companies use their power over us to steal our customers and ultimately steal our business. Retailers need rules that protect competition. I'm speaking just for Tower today, but if you ask

Pam Horovitz at NARM, which is the association that represents music retailers, she'll tell you that all retailers just want a level playing field that let's them decide how to market and sell music. That's what I think our government wants also.

I would have liked to have been accompanied here today by representatives of two trade associations Tower belongs to: National Association of Recording Merchandisers and Video Software Dealers Association. NARM and VSDA have been active before the Copyright Office and Department of Commerce in presenting the legal issues involved in this intersection of copyright law, antitrust law, and consumer rights. Each has prepared a written statement on the topic of today's hearing, and I respectfully request that their statements be included in the record of this hearing.

I thank you for inviting me to testify here today.

Chairman HATCH. Ms. Greenberg, we will turn to you. Thank you for being here.

**STATEMENT OF SALLY GREENBERG, SENIOR PRODUCT
SAFETY COUNSEL, CONSUMERS UNION**

Ms. GREENBERG. Thank you, Mr. Chairman. Consumers Union appreciates the opportunity to represent the interests of consumers

here today, consumers who haven't always had a place at the table in these ongoing discussions about consumers' access to music online.

Consumers Union, as you know, no doubt, is the publisher of both *Consumer Reports*, which is a print magazine with 4.5 million subscribers, and also the publisher of a Web site with one of the Internet's largest paid subscriber bases. We understand the importance and value of copyright protection.

In our role as advocates for consumer and public interest, we also understand that copyright law is a delicate balance between the rights of those create, compile and distribute information, and the ability of the public to get access to that information. We are, in short, pro-consumer and pro-copyright.

We are here today because of our belief that while we must protect the rights of authors of creative works, we should not in the name of copyright unduly burden consumers. Irrespective of the merits or legality of Napster's online music service, Napster has popularized the power of peer-to-peer networking. We believe peer-to-peer, which allows individuals users to share files with other users without going to a central location, has the potential to revolutionize the way we communicate and learn, but it is a model that is in its infancy. Actions that we take today can have the effect of facilitating the development of peer-to-peer networking or chilling its development.

When the VCR was introduced in the 1980's, Jack Valenti, who was with us this morning, lobbying for the motion picture industry made the famous statement, or in retrospect perhaps the famous overstatement that the VCR is to the motion picture industry and the American public what the Boston strangler is to a woman alone.

Of course, we now know the real end of the VCR story. Video-cassettes and rentals are one of the most valuable and profitable components of the entertainment industry. Had it not been for judicious policymakers and judges, the story of VCRs may have had a very different ending. Consumers could just as easily been denied the benefits of the VCR if the industry's "Chicken Little" approach had prevailed.

We are concerned that the recording industry's opposition to Napster and other peer-to-peer online systems may be more of the same. Consumers Union understands the concern of the recording industry that Napster users enjoy creative works without having to pay the artist or recording company. This is a valid issue and we firmly believe that creators of artistic works, be they musicians, artists, authors, or others, must have financial incentives to continue their creative endeavors and should be fairly compensated for their work. Those who add value to their work, like recording studios, have a right to fair compensation as well.

Unfortunately, we believe the Napster debate has been reduced to the question of whether music should be free, and that is the wrong question. Of course, music should not be free, but there is an important point we shouldn't lose sight of. In a very short period of time, there have been over 72 million installations of Napster's online service and the public has manifested a previously unimaginable demand for music distribution online. At the same

time, that public has demonstrated a previously unparalleled appetite for peer-to-peer information delivery.

So where do we go from here? Despite the recording industry's arguments that it has made and is making efforts to provide music online, it appears to us at this moment that the recording companies that control the music business aren't giving consumers what they want. If ever there was a crystal-clear indicator that consumer is there, Napster is there.

To reduce this to even simpler terms, what we have is a new technology, we have a great consumer demand for that technology, but we have an inefficient marketplace that prevents the new technology from operating in a way that appropriately balances the competing needs of copyright owners and the public's right to receive information.

Congress has before it an opportunity to redress this problem and arrive at a fair and equitable balance between copyright owners, creative artists, and the public. Last July when this panel held hearings, Senator Leahy and you, Senator Hatch, expressed hope that the parties might work together toward a mutual agreement. Otherwise, there would be pressure on Congress to create statutory compulsory licenses.

Since that time, there has been a preliminary injunction against Napster and an offer from Napster to pay the recording industry \$1 billion to license Napster to offer its users paid subscriptions. To our knowledge, the industry, with the exception of Bertelsmann, has flatly rejected that offer and has made no counter-offer. Meanwhile, consumers continue to be deprived of access for a reasonable fee to the kind of online service that Napster was providing.

In that vein, Consumers Union believes the best approach would be one that has been tested and proved successful for users of other technologies. We would propose the establishment of a compulsory licensing mechanism through which Napster and other online music providers would have a legal avenue for the 72 million people who have installed Napster to share music online. We urge this Committee to use the models that exist to authorize a Copyright Arbitration Royalty Panel, or CARP, to resolve the disputes over the issue of music royalties between Napster and other peer-to-peer online services and the recording industry.

Compulsory licensing systems we know are not popular with the labels; they are not perhaps popular with others involved in the distribution and the production of CDs in this case. But they do serve both owners and users by reducing the transaction costs involved in licensing through the private market system.

Consumers Union is on record supporting compulsory licensing for both satellite and cable transmission. Compulsory licensing provides a fair profit to the owners of copyright, while ensuring that the public has access to creative works. It has also provided consumers with greater choice.

Let me close by saying that Consumers Union fears that unless Congress provides for compulsory licensing, which is a tried and true system that has worked in the past to provide consumers with access to emerging technologies, we will see a quashing of innovation and competition, and consumers will be the losers for it.

Thank you.

[The prepared statement of Ms. Greenberg follows:]

STATEMENT OF SALLY GREENBERG, SENIOR PRODUCT SAFETY COUNSEL

Consumers Union, a publisher of both Consumer Reports—a print magazine with 4.5 million paid subscribers—and a Web site with one of the Internet's largest paid subscriber bases, understands the importance and value of copyright protections. In our role as advocates for consumer and public interests, we also understand that copyright law is a delicate balance between the rights of those who create, compile, and distribute information and the ability of the public to get access to that information. We are, in a word, pro-consumer and pro-copyright. As Senator Hatch said last July at hearings on this same subject, we must protect the rights of the creator but we cannot in the name of copyright unduly burden consumers.

New technologies historically have challenged our system of protecting creative works through copyright, and required a balancing between the public's right to know and the limited monopoly rights of authors. Whether it was the printing press, the jukebox, the photocopier, cable television, or the Internet, these technologies have forced us to continually revisit the balance between the rights of authors and rights of users to have access to information and creative works. Promoting and fostering innovation is clearly the goal of intellectual property law, but with changing technology we will continue to debate what will best accomplish that goal.

When the VCR was introduced in the early 1980s, Jack Valenti, lobbying for the Motion Picture Industry Association of America, made the famous statement, or in retrospect, perhaps, overstatement that “the VCR is to the motion picture industry and the American public what the Boston strangler is to the woman alone.” Of course, we now know the real end to the VCR story—videocassette sales and rentals are now one of the most lucrative slices of the industry's copyright pie. Had it not been for judicious policymakers and judges, the story of VCRs might have had a very different ending—consumers could just as easily have been denied the benefits of the VCR if the industry's “Chicken Little” approach had prevailed. We are concerned that the recording industry's opposition to Napster and other peer-to-peer online systems may be more of the same.

While it is almost a cliché to speak of the Internet and information technologies as revolutionary, it is nonetheless accurate to say that the Internet has completely changed the way we gather and distribute information. I don't think anyone here would disagree that Internet and information technologies have been responsible for tremendous gains in productivity and an unrivaled period of economic expansion.

As the Internet has developed, several milestones were responsible for huge increases in users on the network: the creation of HTML, the programming language of the World Wide Web, enabling users of the network to exchange information in a common format, and the creation of Mosaic, the world's first generally accessible Web browser. And we believe that peer to peer networking is a milestone on par with these other developments.

Irrespective of the merits or legality of Napster's service, Napster has popularized the power of peer to peer networking. The first Web browser introduced to users the idea that they could instantly get access to information anywhere on the planet—what Napster has done is introduce millions of users to the idea that they can find information by connecting directly with other users.

We believe peer to peer networking, which allows individual users to share files with other users without going through a central location, has the potential to revolutionize the way we communicate and learn, but it is a model in its infancy. Actions that we take today can have the effect of facilitating the development of peer to peer networking, or chilling its development.

CU understands the concern of the recording industry that Napster users enjoy creative works without having to pay the artist or the recording company. This is a valid issue. We firmly believe that creators of artistic works, be they musicians, artists, authors, or others, must have financial incentives to continue their creative endeavors and should be fairly compensated for their work. Those who add value to their work, like recording studios, have a right to fair compensation, as well. Unfortunately, we believe the Napster debate has been reduced to the question of whether music should be free, and we believe that is the wrong question. Of course music should not be free.

But there is an important point we should not lose sight of: in a very short period of time, over 72 million people have installed Napster's online service and manifested a previously unimaginable demand for music distribution online. At the same time, that public demonstrated a previously unparalleled appetite for peer to peer information delivery.

We are concerned that shutting down Napster, and thereby sending a chilling message to other peer-to-peer online systems, will stifle the kind of innovation that brought us the Internet in the first place. The direction taken in response to Napster-like online music services will be instructive to every fledgling peer to peer service, and their network architecture will be directly influenced by legislative actions taken—or not taken—by this panel.

In the aftermath of the Federal court's preliminary injunction ordering Napster to cease providing free downloads of copyrighted music, where do we go? Despite the recording industry protestations that it has made and is making efforts to provide music online, it appears to us that at this moment, the recording companies that control the music business aren't giving consumers what they want. If ever there were a crystal clear indicator that the consumer demand is there, Napster is it. So why have the major labels not stepped up and given consumers what they are asking for?

To boil it down in even simpler terms, we have new technology and we have great consumer demand for that technology. But we have an inefficient marketplace and that prevents the new technology from operating in a way that appropriately balances the competing needs of copyright owners and the public's right to receive information.

We suspect that the recording industry is resistant to changing the status quo and adapting to consumer demand for getting music online to protect current profit margins. According to columnist Thomas Weber writing in the *Wall Street Journal* last week, \$1.50 or less of a CD priced at \$15, goes to the artist.¹ Add in composer's royalties, manufacturing, packaging, and distribution costs and you're only talking about \$5 of the total price. \$5 goes to the retailer, and the record company gets \$5 for marketing costs and profit. But the record company also gets a portion of the manufacturing, packaging and distribution costs through its subsidiaries, so each "cost item" in that chain also may generate profit for them.

Therein lies the problem for consumers. The public demand for online music cries out for a transformation of the way music is delivered, but the recording industry has strong disincentives from transforming their current distribution and marketing system. With the courts ordering Napster to stop providing free downloads of copyrighted music, the recording industry failing to respond to Napster's offers to set up a subscriber service, for which they have offered to pay the recording industry a lump sum of one billion dollars over five years, and the industry's failure to offer the same Napster-style service to consumers themselves, we appear to be at an impasse. And so consumers turn to Congress to properly balance the interests at stake.

We believe the recording industry also fears that online distribution of music could result in total disintermediation. In other words, what if consumers have the means to bypass the label entirely, connecting directly to an artist's Web site and cutting the recording company out of the transaction entirely?

Indeed, the recording industry has demonstrated through its actions that it is entirely aware of this possibility by waging a war on the technologies of online music distribution, rather than going after uses of those technologies. Over the last few years, Congress has already passed the No Electronic Theft Act of 1997 and the Digital Millennium Copyright Act in 1998, both of which would allow the Recording Industry Association of America (RIAA) to go after individuals who are illegally copying. But the recording industry seems not to be going after individual violators; their real interest seems to be in going after the technology. They realize that with 72 million people installing Napster, they cannot all be made criminals. Regrettably, the recording industry appears to be attacking innovation more than it is attacking piracy.

Consumers are paying the price doubly: they are faced with fewer choices and are paying higher prices for those choices. It also appears that the recording industry may be using litigation as a strong-arm business tactic to freeze the status quo and protect its profits. For instance, the Recording Industry Association of America (RIAA) sued MP3.com, a service that merely allowed users to take a CD that they legitimately bought and access it from any location through the Internet. As Michael Robinson of MP3.com testified here last summer, when MP3.com attempted to abide by a court order and get its system licensed, the company ran into a hornet's nest of different licensing agreements and spent large sums of money in the process. This for a service that simply gave users the ability to get online access to music they legitimately purchased and owned. MP3.com's experience is hardly incentive for other Internet innovations.

¹Weber Thomas. "Why Gutting Napster Won't Cure the Blues of the Music Industry." *Wall Street Journal*, March 26, 2001.

We have another concern that may contribute to the diminishment of rights consumers now have. In the offline world, once an individual purchases a copy of music, that individual is allowed to give or sell that copy to anyone he or she pleases, otherwise known as the first sale doctrine.² Yet in the online world, first sale is rapidly disappearing. CU acknowledges that when the first sale doctrine was first contemplated, peer-to-peer online capability didn't exist. That is why we think Congress should take a look at this issue as well.

Congress has a model for addressing and balancing interests to arrive at a fair and equitable balance between copyright owners, creative artists, and the public. Last July, when this panel last held hearings on this issue, Senator Leahy expressed hope that the parties might work together toward some mutual agreement, otherwise there will be pressure on Congress to create statutory compulsory licenses. That hearing happened before the preliminary injunction against Napster was in place, and before Napster had offered to pay the recording industry \$1 billion to license Napster to offer its users paid subscriptions. To our knowledge, the industry, with the exception of Bertelsmann, has flatly rejected that offer and has made no counteroffer. We have neither heard of nor seen any signs of progress. Meanwhile, consumers continue to be deprived of access, for a reasonable fee, to the kind of online service that Napster was providing. We believe the need for Congressional action is even more urgent today than it was last July.

In that vein, Consumers Union believes the best approach would be one that has been tested and proved successful for other new technologies. We propose the establishment of a compulsory licensing mechanism through which Napster and other online music providers would have a legal avenue for the 72 million people who have installed Napster. The compulsory licensing system supercedes the normal marketing mechanism for distributing copyrighted works and allows the prospective user the right to obtain a compulsory license under which he or she can use the work without the copyright owner's permission. In this way, we believe that Congress would help peer to peer networking to realize its full potential.

Congress has set up compulsory licensing systems in several instances (one repealed pertaining to jukebox licensing), each outlined below.

- The Mechanical License, Congress in 1909 created a right against the reproduction of musical compositions in mechanical forms (piano rolls). Congress limited this right however, through the creation of a mechanical compulsory license for musical works.
- The Cable License of Section 111 establishes a compulsory license for secondary transmissions by cable television systems.
- The Satellite Retransmission License establishes a compulsory license for satellite retransmissions to the public for private viewing.
- The Audio Home Recording Act, establishes compulsory licensing-like system by providing immunity from liability for copyright infringement by manufacturers and importers of digital recording devices, but imposes a levy on these devices, the proceeds from which are to be distributed to copyright owners.

We urge this Committee use these models to authorize a Copyright Arbitration Royalty Panel, or CARP, to resolve the disputes over the issue of music royalties between Napster and other peer-to-peer online service, and the recording industry. We also urge the panel to set a time limit in the law to finalize royalties, so that the parties are not debating the issue 3 years down the road, with consumers still left out in the cold.

While we realize fully that rights holders tend to dislike compulsory licensing systems, these systems are products of political compromise; they serve both owners and users by reducing the transaction costs involved in licensing works through the private market system. Compulsory licensing has worked well in other contexts where we have supported it. For instance, CU is on record supporting compulsory licensing for both cable and satellite transmission entities. CU's Gene Kimmelman told the Senate Commerce Committee in 1998 and 1999 that by "eliminating the transaction costs associated with thousands of copyright clearing negotiations, the compulsory license ensures fair compensation to copyright holders while also providing consumers greater opportunity to receive multichannel video programming from a variety of vendors." Those principles apply to music, as they do to cable and satellite. Indeed, without compulsory licensing mechanisms for satellite or cable systems, consumers would not have had access to a broad range of programming and we don't believe these technologies could have flourished. Compulsory licensing provides a fair profit to owners of the copyright while ensuring that the public has access to creative works.

²The first sale doctrine was incorporated into the 1909 Act in 17 U.S.C. Section 27 (1909 Act).

Compulsory licensing has not only provided consumers with greater choice, it also spurred competition. Imagine if Congress had not acted to provide a compulsory license in the case of satellite retransmission of broadcast signals. The only truly viable potential competitor to cable monopolies direct broadcast satellite-would not be in a position to offer consumers an alternative to cable.

We support compulsory licensing because we believe that “killer applications” like Napster will encourage the rollout of broadband Internet services, just as email and instant messaging were responsible for huge growth in the narrowband Internet. Congressional action will be instrumental in greasing the wheels to facilitate this process, thereby bringing users of Napster and other peer-to-peer technologies into the sanctioned marketplace.

Consumers Union is concerned that unless Congress provides for compulsory licensing, a tried-and-true system that has worked in the past to provide the consumers with access to emerging technologies, we will see a chilling of innovation and competition, and consumers will be the losers.

Chairman HATCH. Thank you, Ms. Greenberg. That was very interesting.

Mr. Fish?

STATEMENT OF EDMUND FISH, PRESIDENT, METATRUST UTILITY DIVISION, INTERTRUST TECHNOLOGIES CORPORATION

Mr. FISH. Mr. Chairman, Senators Leahy, Feinstein, and the other members of the Committee, I have the distinct honor today of being the last, but hopefully not the least person to address this Committee on the very important issues that are before it.

In sitting and listening to all of the other testimony, I had an observation. It strikes me each time I hear this debate how many diverse interests there are. You could think of it as a symphony. Symphonies take practice or you have got a lot of discordant efforts. At the same time, symphonies need a framework, and I am here to talk about that framework today.

I am here on behalf of our founder, Chairman and CEO, Mr. Victor Shear, and our organization that has grown from a handful a few years back to more than 350 worldwide today. InterTrust has been focusing on the issues before this Committee since its founding in 1990. We coined the expression “digital rights management” to describe the requisite mechanisms.

It took 9 years and more than \$100 million in capital to bring this technology to market, and we have made many significant inventions along the way. We now provide technology to a number of copyright owners, artists, device manufacturers, software providers, and online services bringing digital information to the Internet. These include Adobe, AOL, Bertelsmann, Blockbuster, Compaq, Diamond Rio, Nokia, Philips—many, many different participants in this process.

Mr. Chairman, let me suggest that at the heart of the issue is how do we bring civility to the post-Napster world without compromising our traditional cultural values or our leadership in technology, as was so poignantly pointed out this morning. We suggest that the answer lies in the following two ideas: first, a balanced partnership between technology and law, and, second, an understanding of what digital rights technology can do and how it should do it.

One might say that technology created this problem, but technology can also help to solve it. To do that, however, it needs a partnership between law and technology. Until now, we have had

technology pitted against law. This technology is called digital rights management, or DRM.

Sophisticated DRM technologies such as InterTrust can provide the mechanism to help effect this partnership of law and technology. It facilitates a workable framework for the efforts of artists, as well as the industries that bring their works to the public. This framework must also satisfy law and the legitimate expectations of consumers. The digital world should live up to the principles most of us believe are the minimum standards we would demand in the traditional analog world.

To be clear, when I am speaking about DRM technology, I am not referring to mechanisms that simply deliver protected music online in return for a payment and then lock it to a PC. Rather, to create the partnership framework I have mentioned, it is critical to create a zone, independent of time, place, or device, where music is protected by technology and where rights-holders and consumers are free to express and protect their rights through the freedom to establish differing rules reflecting their own individual interests.

Robust business models such as download, streaming, subscription, pay-per-listen, or super-distribution are possible. DRM technology, however, can also allow special consumption rules to be created for particular consumers or classes of users, for schools and universities, for libraries, and for consumers with special needs such as the blind. InterTrust Technologies does this today.

Our experience tells us that there are three fundamental requirements in order to establish this framework. First, technology must provide creators of digital information the secure ability to manage and protect their rights throughout the life cycle of the content and however that content may be exploited, and it must operate wherever music is played—personal computer, to PDA, to cell phone, and back again. We live in a connected world.

Second, it must provide copyright owners and value chain participants such as retailers the ability to offer consumers a wide range of usage options.

Third, it must be unimpeachably neutral and a trusted environment in which technology assures these agreed-upon arrangements. It may not in any way advantage any interests, including those of the technology provider. The trusted environment should be open enough to permit multiple formats, multiple services, multiple applications, a true competitive ecosystem. That is why InterTrust restricts itself to building a platform that solely supports third-party businesses. We run no other such services.

In closing, we should remember that the issue is about constructing a civil digital society in the Internet Age, where rules created by citizens and for citizens can be implemented and respected wherever and whenever legitimate interests are in play. InterTrust is helping to make this a reality with a whole variety of partners, many of whom you have heard from today.

Thank you very much.

[The prepared statement of Mr. Shear, as presented by Mr. Fish, follows:]

STATEMENT BY VICTOR SHEAR, FOUNDER AND CEO, INTERTRUST TECHNOLOGIES CORPORATION

InterTrust Technologies Corporation is the leading provider of Digital Rights Management (DRM) technologies, which in the field of copyright protection will secure four objectives: (i) give consumers new freedom to enjoy music and entertainment online; (ii) give copyright owners the means to manage and protect their rights in the works they create and publish; (iii) give effect to elements of law, such as copyright exceptions; and (iv) provide users with the means to manage legitimate personal rights and interests.

Until now, the ability of the creative community to enforce rights in their copyrighted works has never really caught up with the technologies enabling anybody to make and distribute unlawful digital copies. What has been urgently needed is a partnership between technology and law to provide a workable economic framework for the vital efforts of our musicians, writers, actors and artists, and to accommodate and satisfy the legitimate expectations of consumers—including limitations on exclusive rights to the extent they are sufficiently formulated. Sophisticated DRM technology now provides the mechanism to effect this partnership.

InterTrust's DRM technology is now capable of securely managing rights in copyrighted works in the context of peer-to-peer distribution, and can enable consumers to listen, record, and distribute music online without compromising the rights of artists, record labels, and other copyright owners. It also makes it possible for the creative community to offer consumers a limitless range of ways to enjoy music and entertainment: sale of downloads; subscriptions; payper-listen; superdistribution (consumer A delivering material to consumer B and so on); file sharing. It can do so because it associates the technical protection with the content regardless of the channel through or platform upon which it is exploited.

But effective DRM solutions require more than sophisticated technology. They also require credibility and trust. That is why InterTrust restricts itself to building a platform that supports third party businesses. It is not itself a distributor of copyrighted works; a builder of consumer applications such as electronic music players; or a credit card transaction processor. InterTrust's business role and model is that of a utility: it facilitates but strictly refrains from intruding into the business models and distribution channels for copyrighted works. InterTrust's function is not to dictate the arrangements for digital rights management, but to establish and maintain a platform to ensure the neutrality, security, commercial reliability, and trusted interoperability of services and software applications used for the protection and management of rights in digital information of all kinds, including online entertainment. It is fundamental to our vision that this trusted, neutral infrastructure is essential to the long-term effectiveness of DRM solutions, and to their acceptance by copyright owners, distributors, and consumers alike.

Ultimately, the reality of sophisticated DRM technology is about far more than Napster, online entertainment and copyright law. It is about constructing a civil digital society in the Internet Age, where rules created for or by its citizens can be implemented and respected wherever and whenever their legitimate interests are in play. It is this simple proposition that InterTrust is making a reality.

On behalf of InterTrust, I wish to thank Senators Hatch, Leahy, Feinstein, Thurmond, and all the members of the Committee for the opportunity to testify this morning on the important issue of on-line entertainment and copyright law. I would like to tell the Committee about how InterTrust Technologies Corporation has developed Digital Rights Management technologies that in the field of copyright protection will secure four objectives:

- give consumers new freedom to enjoy music and other forms of content,;
- give copyright owners and other value chain participants the means to manage and protect their rights in published works;
- give effect to elements of law, such as copyright exceptions, for ensuring that rights are managed in accordance with public interest;
- provide users with the means to manage their legitimate personal rights and interests.

InterTrust is the leading provider of peer-to-peer Digital Rights Management (DRM) technology. This technology ensures the neutrality, security, commercial reliability, and trusted interoperability of applications and services used to protect and manage rights in all forms of information, including the creative works under consideration here. Our enterprise is focused on the rapidly evolving area of digital commerce in information; our aim is to provide a framework of commercial trust comparable in scope, and at least as reliable, as the systems of trust that underpin commerce in the physical world.

The focus of this Committee extends beyond a simple re-examination of the particulars of the Napster case to the broader questions it raises. I respectfully submit that, from that perspective, InterTrust has a particularly valuable contribution to make. Given our unique position in the DRM arena, we believe we can assist the Committee in considering the complex issues before it.

BACKGROUND ON INTERTRUST TECHNOLOGIES CORPORATION

I founded InterTrust in January 1990. The goal was to provide solutions to many of the complexities involved in realizing the full potential of electronic commerce. It seemed clear that digital commerce would require mechanisms enabling the dynamics of traditional commerce to be seamlessly translated into the electronic world. My associates and I coined the expression Digital Rights Management to describe the requisite mechanisms. In effect, we were looking towards a world in which, where and as appropriate, commerce could be digitally “virtualized”. Over the last 10 years, InterTrust has developed the concept of Digital Rights Management (“DRM”) and has grown from myself and a handful of researchers to a fully-fledged commercial enterprise employing more than 350 people worldwide. Approximately \$340 million of working capital has been provided to InterTrust by its investors, and all of this capital is dedicated to the creation of a digital rights management framework for digital commerce and participant conduct.

The impact of the Internet has meant that the initial and most visible applications of InterTrust’s technology have been for digital music, video, and publishing. Literally any digital information that is shared or stored will ultimately be implicated, however. This includes, for example, medical records, enterprise workflow, financial interactions, and the policy management of any stored or communicated information—policies ranging from privacy rights to enforcing government regulations to reliably automating commercial interests.

As concerns electronic distribution of entertainment products and services, InterTrust has been a very active member of the Secure Digital Music Initiative (SDMI) since its inception, and its employees have chaired SDMI’s Portable Device Working Group and its Screening Group. We played the role of primary developer of the Intellectual Property Management Protocol (IPMP), which became an MPEG-4 standard for electronic devices. We have strategic alliances and partnerships with a number of major enterprises including Adobe, AOL, Bertelsmann, Blockbuster, Compaq, Diamond Rio, Enron, Mitsubishi, Nokia, Philips, Samsung, Texas Instruments, Universal Music and numerous others. They are all actively working with InterTrust DRM technology to further the enjoyment of music, video, published text and other information products on PCs, portable music players, cable systems and mobile phones. InterTrust works with these and other companies to help establish standards, and, through InterTrust’s MetaTrust Utility, to help ensure that consumers and commercial organizations can enjoy a consistent degree of reliability, integrity, and interoperability when they expose their interests through digital interaction. We pride ourselves on working with individuals and companies, large and small, that have interests in, or rights related to, digital information that need rights management.

ONLINE ENTERTAINMENT AND DIGITAL RIGHTS MANAGEMENT

Great creators are normally great communicators, their individual voices collectively embodying and expressing the values and passions of their culture. Using digital technology expedites the accurate dissemination and reception of creators’ works and, when employed in the proper context, digital technology can also support the universe of rights associated with most creative works—the rights of creators, value chain members, users, and societal organizations. Although digital technology can greatly enhance the communication of creators’ works, unless it is properly employed, its use creates severe problems. Digital technology, when improperly used, can deny content creators and their successors the commercially essential return for labor and right to manage and exploit property. The improper use of digital technology—when employed as a vehicle for the unfettered purloining of copyrighted content—directly undermines the basic building blocks of modern society, the respect for the rights of others, as well as proper return for one’s creative output and labor. Moreover, such improper use directly suborns the stable economic basis necessary for further development of art.

Ultimately society loses out as the basic “glue” of commerce and democracy, the civil interaction between multi-party rights and interests and the maintenance of a market for goods and services, is undermined in the service of convenience and self-interest. At times it appears there’s a call to revolt, “free the content,” when

such a call—if extended beyond fair use -obscures the real issues and would seek to legitimize people taking for free whatever they want. Others' rights be damned!

Although the impetus for this hearing may be “file-sharing” and the recent Court of Appeals decision affecting it, it is not just about Napster. It is about the changes that digital technology is bringing to the worlds of art, entertainment and information. It is also about the kind of society that electronic communities and digital technology, used in concert with copyright law, can create. Many people are just now beginning to realize how profound those changes and possibilities are. In under two years and with very little in the way of direct investment, an electronic community of some 60 Napster million file sharers was created. Ordinary consumers used the Napster system to obtain unauthorized copies of copyrighted music without payment when most of them, at least previously, would never have considered buying pirated CDs in the physical world. Other communities are springing up worldwide where individuals communicate electronically and eschew any reference to traditional principles of commerce and property rights.

The Digital Millennium Copyright Act, which this Committee was instrumental in enacting, was the first in the world to tackle the challenges of digital technology. Yet for all its thoroughness, we are probably even now past the point where we could claim that copyright law alone is sufficient to establish adequate mechanisms for the protection and management of rights in creative works (though it is essential that legislators continue to develop the body of digital copyright laws and regulation). Despite shorter revision cycles for law, the ability of the creative community to enforce the rights in their works has never really caught up with the technologies enabling anybody to make and distribute unlawful digital copies. The situation is now being considered by some leading academics as one in which copyright law may in practice become virtually irrelevant.

Society simply cannot afford to accept copyright law becoming irrelevant. And we cannot afford to set the extraordinary example of dispensing with the rights of content providers because we are unwilling to develop a framework for proper commercial and civil behavior. There is therefore an urgent need for a partnership between technology and law that effectively maintains the underlying commercial and social principles of modern free society. With respect to online entertainment the partnership must provide a workable framework for the efforts of our musicians, writers, actors and artists. We need a partnership between government and content commerce participants that accommodates and satisfies the legitimate expectations of American citizens—including any limitations on exclusive rights appropriate for an intelligent public policy.

Sophisticated DRM technology such as InterTrust's can provide the mechanism to help effect this partnership. While technical complexities and challenges abound, the mission is achievable: to provide a combination of technical mechanisms and social compacts that allow the transfer of the basic features of traditional commerce into the digital market place. The means to achieve this goal are now at hand, and the means to continue developing a flexible, free, and safe commercial digital environment, are readily accessible. There are, of course, new and complex commercial, economic and social issues to be addressed. But this cannot deflect us from the simple, basic responsibility that we all have, to not settle for over-simplifications that result in distorting, unfair, and socially and commercially flawed solutions. Rather, we must strive to allow the digital world to live up to the principles most all of us believe are the minimum standards we would demand in the traditional, non-digital world.

The basic principles of granting rights to creators to control the use of their work and of maintaining trusted systems for commerce remain as valid as ever. We should not ignore the opportunities as they arise of reviewing current copyright limitations and other accommodations that were made before the advent of effective digital rights management to ensure they continue to serve these principles. We should also be ready to reshape these limitations, where necessary, to fit the emerging digital marketplace. Above all we should be driven by a simple principle: to maintain a free and effective commercial society that, in a balanced fashion, supports the rights of all participants.

DIGITAL RIGHTS MANAGEMENT TECHNOLOGY

It is important to understand from the outset that when talking about DRM technology we are not referring to simple mechanisms that, say, carry protected material from a server to a client in return for a payment, locking the material to a single device. Such a proposition offers nowhere near the degree of flexibility and coverage necessary to support either traditional or new business offerings. Post delivery, persistent protection of commercial interests, flexibility in use of content across

devices and locations, and flexible interaction with content, are all priorities for content value chain participants. In the context of music as it relates to Napster, users want to play music on-line or off-line, and they want the right and ability to combine music into playlists that are used to create a specific personal or group music experience, for use wherever and whenever they wish.

The technology system that InterTrust has developed protects content, in the instance of this discussion music, on a persistent basis throughout its commercial lifecycle. It does this by binding rules governing content use with governed content. This tamper resistant association persists regardless of the channel through or platform upon which the music is played, and the number of handlers of the content, the duration of time, or the physical location of the content. InterTrust technology creates a zone— independent of time, place, or device—where music is governed by technology and where rights-holders, including consumers, are free to express and protect their rights through the freedom to establish differing rules reflecting their individual interests.

Within this technical protection zone, digital information such as music can be offered to consumers via a virtually limitless range of models: sale of downloads; subscriptions; pay-perlisten; superdistribution (consumer A delivering material to consumer B and so on); and file sharing. This freedom is also available for the implementation of a richly diverse range of policies that govern usage, and any consequences of usage, in relation to groups of any nature, such as special interest groups. To accommodate statutory limitations on copyright, special consumption rules can be created, either through law or through accepted practice of rightsholders, for particular consumers or classes of users: for schools and universities; for libraries and archival institutions; and for consumers with special needs such as the blind. Whatever the needs, whatever the relationship between different participants the digital information remains persistently protected while freely available according to agreed rules of use.

If this protection is to remain effective throughout the lifecycle of the content then it follows that it must be possible to change the rules relating to use. Material can have a succession of different owners. It can change in value; it can be traded for different purposes; it can be used on multiple, different devices; and it can be loaned to other parties. Our system anticipates and accommodates all these possibilities. In our system, digital information and the rules governing its use by a particular user can exist and move independently of each other, coming together to give effect to the agreement between supplier, distributor, and consumer, and respecting whatever rules may be applied by government, or, for example, by financial institutions.

An efficient system of protection must not only accommodate a wide variety of business offerings. It must also support the complex value chains through which many of the offerings are delivered. The architecture InterTrust has developed supports value chain relationships based on traditional commercial principles—we call this digital enabling of value chains “chain of handling and control”. This means that each actor in the value chain is able to create the rules it wishes to apply to the material in question within the scope of authority granted to the participant by the previous or governing actors in the value chain. A publisher could establish the commercial terms for a work within the authority granted by the author; the distributor could then set rules within the scope of authority granted by the publisher and so on through the value chain, all in accordance with law and accepted practice.

REQUIREMENTS OF DIGITAL RIGHTS MANAGEMENT

We believe there are a number of precedent requirements for effective digital rights management of content. First, it must provide creators of digital information the ability to manage and protect their rights throughout content lifecycles and however content may be exploited. This means that a DRM system must be secure and resilient to tampering, and certain elements of the protection system must accompany the copy of the work as it is passed from party to party, format to format, platform to platform.

Second, it must support commercial flexibility so that it can accommodate the arrangements struck between copyright owners, their customers, distributors, retailers and other value-adding participants. This means that a rights management system must provide content creators and/or publishers the means to allow consumers choices appropriate to the commercial circumstance.

Consumers must be able to enjoy copyrighted works, and the system must permit consumer arrangements to vary based on the terms agreed to by the content commerce participants.

Third, it must provide a neutral and trusted environment in which technology assures these agreed upon arrangements. The rights management technology must

be unimpeachably neutral, that is it may not in any way subtly or secretly advantage any hidden interests, and further, it is essential that the rights management technology not advantage any out-of-context interests of the rights management technology provider. Consequently, for example, neither a rights holder, nor a consumer, nor the rights technology provider should be able to alter or tamper with any agreed upon commercial arrangements once agreed or impede the expression of a parties' rights or interest.

Unless a rights management system meets these requirements—that is, unless the trust system is itself unimpeachably trustable—it will fail to satisfy the legitimate interests of businesses, consumers, and government. Further, unless a rights management system is able to maintain its trust attributes regardless of the underlying digital commerce platform, device, or application, it will fail one of two tests. Either the system will (A) lack reliability in protecting participant rights, since a loosely coupled array of rights systems, without a unifying maintained rights environment, will readily succumb to hackers; or the system will (B) lack interoperability, and consumers and commercial participants alike will lose the convenience and efficiency essential to content commerce, and risk having their interests subordinated to the interests of a party controlling a narrow, proprietary environment.

In the domain of music, InterTrust DRM technology is now capable of permitting consumers to listen, record, and distribute music online in ways that do not compromise the rights of artists, record labels, and other copyright owners. It is capable of managing the rights in copyrighted works in a secure manner in the context of peer-to-peer distribution. Its technology supports the ongoing effort of Digital World Services (DWS), a Bertelsmann subsidiary, and the Universal Music Group, as well as many other interests both large and small, enabling them to implement new business models for the distribution of music on-line. A leading international music group, Daft Punk, for example, recently accompanied the release of its latest album with a novel application of InterTrust technology. The band is encouraging traditional retail relationships and creating digital economy value for its fans by enabling those fans who have purchased the CD to access the group's web site and to download additional music—at no further cost, but protected with InterTrust DRM.

Effective DRM solutions require more than sophisticated technology. They also require credibility and trust. That is why InterTrust restricts itself to building a platform that supports third party businesses. It is not itself a distributor of copyrighted works; a builder of commercial consumer applications, such as electronic music players; or a credit card transaction processor. InterTrust's MetaTrust Utility, the core of InterTrust's business interests, functions as a utility. It facilitates—but refrains from intruding into—the business models and distribution channels for copyrighted works. Its function is not to dictate the arrangements for digital rights management, but to establish and maintain a platform that ensures the neutrality, security, commercial reliability, and trusted interoperability of services, software applications, and devices used for the protection and management of rights in digital information of all kinds. A trusted, neutral infrastructure is essential to the long-term effectiveness of DRM solutions, and to their acceptance by copyright owners, distributors, and consumers alike.

CONCLUSION

DRM technologies should give consumers new options for legitimately acquiring and enjoying music and other forms of online entertainment, while ensuring that copyright owners and other commercial participants have the means to manage and protect their rights. Enabling peer-to-peer distribution of music and other copyrighted works without compromising copyright is an obvious example. In our view, sophisticated DRM solutions must support the fundamental principle of any effective copyright system: that of striking the correct balance between protecting the rights and interests of copyright owners while promoting the interests of the wider community and facilitating the efficient and flexible dissemination of, and greater access to, music and other copyrighted works.

Ultimately, the reality of sophisticated DRM technology is about far more than Napster, online entertainment and copyright law. Policy makers, consumers, and business globally will come to realize that the "Napster issue" isn't just about music and the Internet. It is about constructing a civil digital society in the Internet Age, where rules created for and by its citizens can be implemented and respected wherever and when ever legitimate interests are in play. It is this simple proposition that InterTrust is helping to make a reality.

In closing, InterTrust once again thanks the Committee for the opportunity to present testimony on this important issue, and looks forward to working with mem-

bers of the Committee as they consider the important issues related to online entertainment and copyright.

STATEMENT OF TODD SLOSEK, INTERTRUST TECHNOLOGIES CORPORATION, SANTA CLARA, CA

Washington, D.C., April 3, 2001—Victor Shear, the founder and CEO of InterTrust Technologies Corporation, testified today before the United States Senate on the critical role that Digital Rights Management (DRM) solutions will play in the future of peer-to-peer file sharing technologies like Napster and other online entertainment.

At a hearing of the Senate Judiciary Committee on online entertainment and copyright, Shear testified that the InterTrust DRM technology is now capable of securely managing rights in copyrighted works in the context of peer-to-peer distribution, and can enable consumers to listen, record, and distribute music online without compromising the rights of artists, record labels, and other copyright owners.

“The ability of the creative community to enforce the rights in their works has never really caught up with the technologies enabling anybody to make and distribute unlawful digital copies,” said Shear. “We urgently need a partnership between technology and law to provide a workable economic framework for the vital efforts of our musicians, writers, actors and artists, and to accommodate and satisfy the legitimate expectations of consumers. InterTrust’s sophisticated DRM technology now provides the mechanism to effect this partnership.”

InterTrust DRM technology makes it possible for the creative community to offer consumers a limitless range of ways to enjoy music and entertainment: sale of downloads; subscriptions; pay-per-listen; superdistribution (consumer A delivering material to consumer B and so on); file sharing. It can do so because it associates the technical protection with the content regardless of the channel through or platform upon which it is exploited. For example, the leading international group, Daft Punk, uses InterTrust DRM technology to enable fans who have purchased the group’s latest CD to download additional music from its web site.

“Ultimately, the reality of sophisticated DRM technology is about far more than Napster, online entertainment and copyright law,” Shear told the Senate panel. “It is about constructing a civil digital society in the Internet Age, where rules created for or by its citizens can be implemented and respected wherever and whenever their legitimate interests are in play. It is this simple proposition that InterTrust is making a reality.”

InterTrust [Ticker ITRU] is the leading provider of peer-to-peer Digital Rights Management (DRM) technology to ensure the neutrality, security, commercial reliability, and trusted interoperability of online applications and services. InterTrust has strategic alliances and partnerships with a number of major enterprises, including Adobe, AOL, Bertelsmann, Blockbuster, Compaq, Diamond Rio, Enron, Mitsubishi, Nokia, Philips, Samsung, Texas Instruments, and Universal Music, using InterTrust technology to enable consumers to enjoy music, video, published text and other information products on PCs, portable music players, cable systems and mobile phones. For more information, please visit the InterTrust website at www.intertrLIST.COM.

Chairman HATCH. Well, thank you so much. This has been a particularly interesting panel to me. I am sorry I had to step out for a minute or two, but I got most of the message here and it was very good.

In closing, I appreciate the time and effort all of you have put in for your testimony today, and the artistic efforts of those whom you represent. We now have increased appreciation of the continual evolution of Internet music and the legal and ethical complexities that has generated. It seems to me this hearing has brought that out.

As with any new technology, the scientific advancements often outpace the necessary legal adjustments. We have recently seen similar discussions in the current situation with molecular biology and genetic research. The research has outpaced the law.

My goal has always been to respect the efforts of individual artists and associated intellectual property rights, but at the same

time to allow a legal framework that does not stifle the technological innovation which is the foundation of our entertainment industry, which is, of course, the envy of the whole world.

Let me just say this: We will leave the record open until Friday, and we will allow any member of this Committee to submit questions, which I hope you will answer within 2 weeks. It is important that you get your answers back to us, because we are building a record here that literally may determine the future for all of you with regard to music, and I would like to do it the right way.

I don't have any axes to grind here. I think I have expressed how important every aspect of this business is, but I do have an axe to grind in that I love the business and I love what it does. I love the softening it brings to America. I love the good things about the business that really mean so much to all of us.

I think Mr. Valenti's comments today of how important this business is vis-a-vis the rest of the world and vis-a-vis our balance of trade—this is the one industry, and I am talking about the whole entertainment industry—movies, music, books, et cetera—it is the one industry where we really have a great balance of trade surplus.

To me, it is an industry that brings a great deal of joy and satisfaction to millions and millions and millions of people out there, and we want to keep it going. But it is also an industry which is very tough to break into. I know a lot of really fine writers and artists who will never have a chance, in my eyes, because of the way the industry is currently structured, and it is a sad thing.

I remember when I received my first royalty check from ASCAP that they had collected. I was at an ASCAP annual meeting and there were about 1,000 people there, all writers, and I raised my check and said I just got my first royalty check. The whole place went out of control; everybody stood and applauded and stomped their feet.

When I sat down, Marilyn Bergman, who heads ASCAP, reached over to me and said, "Senator, the reason they are so excited is because none of them will ever receive a royalty check. And yet there is some real talent out there that ought to be compensated."

I think Napster understands that the court is right in determining that Napster needs to operate within the legal framework of the law, and they are trying to do so. I said to the industry that they ought to capture Napster, because it is a great peer-to-peer system that literally people love, especially our young people, and I think our young people are willing to pay something to be able to use Napster.

I would hope that we could do this without having the compulsory licensing situation. I don't know that we can, but I hope that we can. That is my goal. We have come a long way since last summer, but in my opinion we haven't gone anywhere near as far as we should go, and we haven't accomplished anywhere near what we should accomplish. There is all too much litigation and in-fighting in this industry that ought to be resolved, it seems to me, by good business plans and good, honest approaches inter-industries. I hope that we can do that.

This has been a great hearing for me because I have learned a lot from it, and I am not going to forget what I have learned here today. I just want to thank all of you for being here.

With that, we will adjourn until further notice.
 [Whereupon, at 1:47 p.m., the Committee was adjourned.]
 [Questions and answers and submissions for the record follow:]

QUESTIONS AND ANSWERS

**Responses of the Recording Artists Coalition to questions submitted by
 Senator Leahy**

1. *Compulsory licenses and licensing disputes*—RAC believes that the content owners and content users must be afforded a reasonable time period to develop a licensing system without government intervention. A fair system might be created if the parties engage in “good faith” negotiations. However, if an agreement cannot be reached within a six month to one-year time period, then Congress should step in and implement a compulsory license system that fairly compensates the recording artist and the record label. Without a compulsory system or a functioning voluntary licensing framework, there will be a disincentive to use music on the Internet and that would harm all parties. The goal of Congress should be to provide incentives to use music on the Internet, but only in the absence of a voluntary framework should a compulsory license system be implemented to accomplish that objective.

RAC does not consider contract provisions requiring the artist’s approval to grant rights for Internet delivery of music as a serious roadblock to increased Internet distribution of music. Most artists will agree to such a request from their record label, so long as the record label acknowledges the label’s obligation to negotiate with the recording artist as to the appropriate division of receipts, including advances on the entire licensing deal, equity participation, etc. There are few provisions in artist contracts providing much negotiating leverage. Provisions such as “anti-coupling” provide artists with a modicum of control and rare negotiating power. It is a cause of concern, however, that the “anti-coupling” clauses in some new artist contracts have been eroded for some uses in the digital space.

2. *Historical instances in which compulsories were created as raised by Mr. Barry*—Mr. Barry is right to point out that compulsory licenses have been used in the past to license music. However, just because there have been compulsory license systems created in the past does not mean that Congress should or must step in immediately. In both instances cited by Mr. Barry, the impasse between the content owners and content users was clear and intractable. A compulsory license system was only implemented after extensive negotiations failed, and essentially all other options were exhausted.

At this point in time, RAC does not believe that all options have been exhausted. The key condition, however, must be open and fair “arms length” negotiations between the parties. If the record labels refuse to negotiate in “good faith” or simply perpetuate the status quo, then Congress should strongly prod the record companies and music publishers to enter into “good faith” negotiations with the independent Internet companies. In the case of Napster, Congress should implore the record labels and music publishers to offer Napster license rates on essentially the same terms as provided by them to other Internet content users so long as Napster follows through on its assurances of security. No one could have anticipated the public’s tremendous demand for interactive music or out-of-print recordings. Therefore, Napster’s effort to create a pay system to legitimately meet this consumer demand should be supported. As stated before, however, if the parties are unable to independently develop a new system within six months to one year, then Congress should intervene as a “last resort.” Congress can then rely on the precedents set by the previous compulsory music license systems to craft a new Internet music compulsory license system.

3. *Digital Rights Management*—RAC has no evidence either supporting or disputing the existence of adequate technology.

4. *How soon is soon*—Before Napster became so popular, the major record labels’ forays on the Internet market were apprehensive. The labels released a very limited selection of cumbersome, encrypted downloads at exorbitant prices. The record labels simply did not listen to the fan’s demand or recording artist’s excitement for music on the Internet. In particular, many recording artists have been pushing record labels for years to take a more serious and comprehensive approach to the Internet. The label’s inaction created a vacuum directly leading to the creation of Napster. Napster simply responded to consumer demand while the labels did not. As such, it is still in large part up to the record labels to determine in what fashion and when digital content will be fully exploited. RAC hopes sooner rather than later and with consideration for the artists’ concerns. With that stated, however, the most

important element of an Internet music business model is the continued existence and expansion of a viable independent distribution system on the Internet. Systems like a fee-based Napster will not only provide an outlet for independent recording artists and those recording artists signed to major labels who are not given the major star promotional push, but these independent Internet music sites will challenge the major labels to continue on an aggressive course and timetable.

5. All other issues will be dealt with below.

WORK FOR HIRE

RAC believes strongly that Congress should reexamine the work for hire provisions in the 1976 Copyright Act with an eye toward clarifying authorship issues of sound recordings. However, before any real progress can be made on the work for hire issue, the record labels, represented by the RIAA, must fundamentally change their relationship with recording artists and more importantly, with the organizations and groups representing recording artists. While paying great lip service to the importance of the recording artist to their companies in testimony before Congress, the record labels and the RIAA, have adopted a policy of indifference and confrontation regarding work for hire. The RIAA has made it very clear that they are not interested in meeting or negotiating with the recording artists. Nor have they shown a willingness to fulfill the strong desire of Congress (specifically this Committee) for the parties to negotiate an acceptable work for hire amendment that would be supported by all factions in the music industry and Congress. Apparently, the RIAA has taken the position that they will fight this issue in court, thereby taking full advantage of the immense difference in financial resources between the record labels, owned and supported by multinational corporations, on the one hand, and the recording artists on the other. This record company posture is unacceptable to the recording artists, and should be unacceptable to Congress.

As the record labels have no intention of starting any kind of substantive dialogue with the recording artists, it is imperative that Congress intercedes and calls for hearings on this issue. All sides in this debate—there are many—must be heard in a “blue-sky” forum. Academics must offer their counsel, and even producers, backing performers, and the unions must be given the opportunity to present their views. Only when a full public airing of all viewpoints is made, can the parties and Congress fashion a fair and sensible amendment or, in the alternative, decide to refrain from offering an amendment. This is how the Copyright Law has been amended in the past. There is no reason to veer from this democratic and mutually respectful tradition.

Seemingly, the record labels learned very little from the work for hire episode. At the core of this conflict is the disconnect between the public perception of recording artist/record company relations, and the reality. Record companies publicly portray the recording artist as a partner in their enterprise. The record companies use this image of a working “partnership” between recording artists and record companies as a way to entice recording artists to sign with their companies. However, once the record contract is signed, generally the record labels true goal, that of creating an employer/employee relationship, quickly replaces the illusion of a partnership. Recording artists are not employees. We are not entitled to the benefits of employees such as pensions and health care, and as such we do not create works for hire.

In fact, the working relationship between a recording artist and a record company is that of a joint venture/partnership. Other than the standard boilerplate work for hire language that is mandatory and non-negotiable in almost every record agreement with a major label, there are no contractual indicia of an employer/employee relationship. So while the recording artist works with the record company as a functional partner, the record company treats the recording artist as an employee. The record companies must treat recording artists more like partners, which in fact they are. If the record labels would listen to and respect the recording artists’ collective political and economic voice, tremendous progress could be made to resolve the lingering political and contractual differences between the recording artists and the labels, including work for hire.

COMPULSORY LICENSES AS A LAST RESORT

This issue is addressed above.

INTERACTIVE DIGITAL PERFORMANCE RIGHT

The Digital Performance Right in a Sound Recording Act of 1995 created the first performance right for the performers of music. Congress mandated a royalty payment of 50% to the copyright holder (most often the record label), 45% to the fea-

tured artist, and 5% to the non-featured musicians and vocalists. This royalty applies only to noninteractive webcasting as defined by the compulsory structure of the Digital Millennium Copyright Act. The problem is that for an interactive service such as Bertelsmann/Napster, My.Mp3.com, MusicNet, or Duet, the compulsory license does not apply: Artists lose their 45% and have to settle for whatever they are promised in their label deal. This might range anywhere from 7% to 50%, but more importantly would be recoupable against the artist's outstanding balance. As such, for most artists, there will be little revenue from interactive music services under the licensing structure that exists today.

Writers of music share a performance right with publishers. The writer's 50% share is paid directly to the writer, and is not subject to recoupment. RAC believes that digital performance rights for sound recordings should mirror the writer's system.

The Digital Performance Right in a Sound Recording Act contains provisions for labels to strike exclusive licenses with webcasters. Under an exclusive license, artists once again potentially lose the 45% afforded to them by the compulsory. The difference between a direct payment to an artist and a recoupable payment is dramatic for both the artist and the label. For the artist, it may be the difference between some payment and none. Since the incentive is greater for the label to negotiate directly with webcasters, the labels could retain more money possibly at a lower rate.

There is also the matter of equity stakes the labels have negotiated with digital media companies. It is now common for the labels to take equity in digital media companies as a precondition to licensing their content. For instance, AOL Time Warner, Bertelsmann, and EMI hold equity in MusicNet, and Sony and Universal in Duet—equity shares that will not be offered to recording artists. Perhaps one way to level this inequity is to ensure direct, substantial, and non-recoupable payment to artists from interactive music services.

INDEPENDENT ARTISTS

The answer to this question must be in two parts. First, the issue of new artists signing major label agreements will be addressed, and second, the issue of independent artists will be addressed:

A. New Major Label Artists—A young recording artist signed to a major label has many obstacles to overcome. The rate of success of new artists is incredibly low. Most do not get past their first album release, and for those who do, the success rate after that is still quite low. This is a very tough business. The Internet provides a new artist with a valuable promotional tool that had never existed before. A new artist can use the Internet to release promotional tracks and drive traffic their way. New artists can create web sites that provide promotional information and develop a degree of interactivity with their fans. In many instances bands communicate with their fans by amassing an e-mail database. They can inform their fans when and where they will be performing live, or when their new album is being released. They can interact with their fans through chat rooms, and in some instances they receive feedback from their fans about their music. In fact, the band Journey recently revised an unreleased album, including creating new tracks, based on feedback from fans who heard the album after it was prematurely put on the Internet without the band's approval. The Internet undoubtedly provides the newly signed artist with an unprecedented marketing and promotional tool. Furthermore, the Internet is, as of yet, unproven as a primary distribution mechanism. New artists still rely on CD sales and it remains difficult to obtain shelf space in the terrestrial retail outlets. The promise of independent Internet distribution is unlimited "shelf space".

Unfortunately, many major labels are beginning to acquire more and more Internet rights from bands when they are signed. Some major labels now try to own and/or control an artist's web site, even if the site was created before the recording agreement was signed. They are especially concerned about controlling data which is stored on the web site, and in some instances, they have attempted to exclusively control the artist's trademarked name on a web site address even after the termination of the recording agreement. The newly signed artist must try to retain these rights so the artist can take a substantive role in promotion during and after the deal. Major labels are very shortsighted in this regard. By seeking to control an inordinate amount of Internet and digital rights of the newly signed recording artists; they are unwittingly ensuring that the failure rate of new artists remains at the same level or conceivably gets worse. Major labels have cut promotional budgets and staffs across the board; especially those recently acquired by multinational corporations. The labels must apportion their shrinking promotional money and manpower to a greater number of deserving bands. A new band might well find itself in the

middle of this type of number crunching that ultimately may result in record label neglect. At times the only player actually promoting a new band is the band itself. A new act must retain as many Internet rights as possible so as to give itself a fighting chance in the ever more constricted major label market.

B. Independent Artists—A viable independent Internet distribution system must be allowed to survive. Otherwise, independent artists will not be able to take advantage of the wonderful promotional, marketing, and creative benefits of the Internet. The Internet provides many independent recording artists with an outlet that was simply not in existence before. The major record companies should not be allowed to destroy or inhibit independent online distribution in the name of copyright infringement enforcement, when in fact, its destruction will only secure Internet market dominance for the major labels. Will the major labels willingly allow for competition with independent artists through an Internet system the majors control such as MusicNet? There is reason to be concerned that the major labels will only want their respective artists to be promoted via the Internet. This is the most compelling reason why the major labels should license their music to Napster and services like it, so that independent distribution will survive. Otherwise the independent artist will be as isolated as ever.

CONTRACTUAL ISSUES

For years, recording artists and their representatives have recognized and vilified the antiquated, but universally used, standard recording agreement. Some surmise that the standard recording agreement, with all of its anti-artist provisions, arguably constitutes a restraint of trade under the laws of the United States. There is some degree of support for this point of view. Courts in the United Kingdom have at times ruled that certain standard music industry contracts constitute a restraint of trade under the laws of the United Kingdom, and perhaps even under the laws and regulations of the European Community, if the court determines that the contract in question is oppressive and against the public interest. In those instances UK courts have rescinded or terminated contracts and at times awarded recording artists with significant damages. Based on this precedent in the UK, this Committee should examine the standard recording agreement as is used in the record industry today in the United States to determine whether there is any basis to conclude that this type of standard agreement also violates US law. The following are examples of certain controversial provisions Congress may find troublesome:

1. A key issue in many of the United Kingdom restraint of trade cases is the inordinately long term of the standard contract. Most major label agreements require a commitment for six to eight albums, with a term that could conceivably last well over ten years. The United Kingdom and the State of California have tried to address this problem either through court intervention or through the legislature. (No action has been taken elsewhere in the United States.) Courts in the United Kingdom have ruled at times, that as a matter of UK law an excessively long term recording agreement, as well as other types of similar agreements in the music industry, constitutes a restraint of trade. The State of California responded by enacting Labor Code 2855 which prohibits, under certain circumstances, a term for entertainment industry personal service contracts longer than seven years. RAC believes a legislative solution is desirable, and therefore Congress should seriously consider enacting a seven-year federal law similar to the law in California. While the California law is not perfect, Congress should consider it as a guide. Free agency in the music industry will help the established artists, the new artists, and the independent artists. Free agency in the movie industry has been a fantastic success, increasing the economic viability of both the studios and the actors. In the music business, both the record labels and the recording artists will benefit from a free agency system that places a premium on success and gives artists a new degree of control over their careers. This is why a federal seven-year rule would be good public policy. It guarantees competition and innovation in the music industry.

2. The majority of recording artists will never achieve financial success or independence while the very onerous recoupment policy remains a staple of the standard record agreement. As Chairman Hatch has stated in the past, this is the only industry in which, after you pay off the mortgage, the bank still owns the house. This standard recoupment policy is also a very compelling reason why Congress and the Courts should recognize that a recording artist is not an employee or independent contractor of the record company. Congress should undertake a very close examination of this policy.

3. When a band signs a record contract with a major label there is almost always a "leaving member" clause. This type of clause mandates that a recording label has the right to retain the services of a leaving member of a band as a solo artist.

4. The work for hire provision of the standard record agreement offers another compelling example of a provision which raises anti-competitive concerns as it denies the creator of the work the right, otherwise granted to all other copyright creators in similar circumstances, to exercise termination rights. Essentially, the work for hire provision tries to contractually deny the recording artist their termination right, even though the Copyright Law clearly does not include sound recordings as a qualifying category for work for hire status.

5. Recording artists who also write their own music often must waive the full, statutory mechanical royalty rate as a precondition to signing a record contract (the “controlled compositions” clause).

In almost all record contracts, the standard royalty is drastically reduced for all sorts of inappropriate and arbitrary reasons. For example, a recording artist will receive a reduced royalty if a record is sold in a foreign territory, if the record is sold in a PX or a military base, if the record is released in a “new format or technology,” and if the record is sold through a record club. The major labels cross-license their catalogs to record clubs, such as Columbia House and BMG Direct. The labels take enormous advances that they do not share with recording artists and pay artists based upon a 50% royalty rate. RAC is also concerned that this long-contended practice is extending to the online marketplace. With Mp3.com, for example, each of the major labels took \$20 million advances on blanket licenses—advances they have not offered to share with artists. A certain amount of records will be distributed as “free goods” when in many instances the recording agreement provides that the record company may include these records in special merchandising programs. In these instances, the record company would still get paid for these records while the artist would not. Some contracts actually charge a packaging deduction against the recording artist for sales of records via the Internet. In other words, the record company does not create any packaging, but nevertheless charges the recording artist for the non-existent packaging. Sometimes these packaging charges amount to 25% of the standard list price of a record. RAC member, Tom Waits sums up the situation very nicely with this prophetic line in his song “Step Right Up”: when it comes to recording contracts, “the big print giveth, and the small print taketh away.” All in all, the practices of the record industry relating to calculation of royalties warrant serious attention.

All of the above are compelling reasons why Congress should investigate, understand, and hopefully act to change the very basic way that business is conducted in the music industry. Even though the record companies will protest, this type of intervention will help all concerned, including the record companies, as it will revitalize creativity and guarantee that the record industry will be a vital and important American treasure for many years to come.

Responses of Mike Farrace to questions submitted by Senators Hatch, Leahy and Kohl

I am pleased to provide these responses to the written questions asked subsequent to the April 3, 2001 hearing. I thank the Judiciary Committee for the attention it is giving to the need to encourage ample dissemination of creative works and the importance of maintaining vigorous competition in the distribution of sound recordings.

RESPONSES TO WRITTEN QUESTIONS FROM SENATOR HATCH

Question: One argument we have heard in favor of a compulsory license is that music has so many pieces to license and there have been substantial disputes between the record labels, the publishers and technology companies like MP3.com about how to get the publishing rights cleared in the volume demanded by online offerings. Some have suggested that a stumbling block to getting the labels to license sound recordings is that they may not have the rights from their artists to grant these rights. I understand there may even be problems with the MusicNet offering to some degree because of these impediments. Would any of you be interested in commenting on this particular problem and suggest ways to remedy it?

Answer: It is Tower’s understanding that while many artist contracts of the past may not have included language providing for distribution via new configurations, the language of most artist contracts today acknowledges that record companies will face an ever-changing landscape of technological opportunities for distribution, and therefore, contract language provides for the record companies’ ability to exploit copyright via new configurations and channels of distribution which may not specifi-

cally be identified by name. More importantly, however, if such a stumbling block exists for a label, we believe it should preclude content availability for MusicNet or Duet just as it would for a delivery system using an independent company such as Tower. Conversely, if MusicNet and Duet can be licensed, so can Tower.

It may also be useful to note that disputes over ownership of copyrighted material have existed in the past, and can logically be expected to exist in the future. A compulsory license would not address issues of ownership. We believe Congress is correct in hesitating to impose an extreme measure such as a compulsory license without giving the marketplace time to offer its own solutions. At the same time, we urge the Committee of the Judiciary to view with caution claims of stumbling blocks that appear to exist only for companies not owned or controlled by copyright owners.

Question: Mr. Hank Barry argues that we have created compulsory licenses in the past, for publishing rights in music and in rebroadcast of television programming because it was difficult to clear the rights to the myriad creative interests involved in making up a broadcast day. Would anyone like to explain why that analogy does or does not obtain in the online music and entertainment world?

Answer: The analogy appears to apply. A song can have more than one writer and owner; an album can have multiple writers; a compilation album or soundtrack can involve multiple labels and distributors. Ed Murphy, in his testimony on behalf of NMPA, acknowledged that the size of the licensing demand placed on Harry Fox by just MP3.com was far in excess of their current licensing capability. However, Mr. Murphy also insisted that they were working hard to meet not only the needs of MP3.com, but to anticipate the licensing needs of the industry as a whole. We readily acknowledge that many in the industry have been working feverishly to address the myriad rights involved in creating a digital marketplace. We believe that while current progress has been slower than we would like, a careful review of the industry's ability to solve the licensing issues identified at the hearing is necessary before concluding that a compulsory license is required.

Tower supports the concept of Section 115, which allows anyone to obtain a compulsory license to make and distribute phonorecords of a copyrighted work once that work has been distributed to the public, thereby encouraging more creative uses of the work while insuring that the copyright owner receives a reasonable royalty payment. The public may benefit from similar tools applied online to eliminate the potential logjam created when an entity that controls a copyright frustrates the widespread distribution intended by the Constitution. Some conditions upon the licensee may be warranted to insure that the right to a compulsory license to make a reproduction via a digital phonorecord delivery (DPD) be available only to those who can demonstrate the ability to (a) be accountable for the number of DPDs actually distributed and (b) can deliver them in a reasonably secure format. (See, for example, House Report No. 76-1476, noting the authority of the Register of Copyrights to prescribe regulations pursuant to Section 115 containing "detailed provisions ensuring that the ultimate disposition of every phonorecord made under a compulsory license is accounted for.") These details are beyond the scope of this response. However, Congress should reasonably expect that a statutory framework for this could be developed with the help of knowledgeable experts if compulsory licensing becomes warranted.

Question: I have heard a number of entertainment companies say that acceptable protection for online content simply does not exist yet, that existing Digital Rights Management and watermarks, wrappers, or encryption, is simply not good enough to protect valuable content. Yet we have a number of technology companies here today who believe that they have such a solution, and now we have announcements of online initiatives from all five major labels, which suggests the technological protections have developed recently. Would any of you care to comment on the state of technological protection for content?

Answer: Our belief is that the *copyright* management through watermarking and encryption available through existing systems are suitable and more than adequate for use in launching the sale of digital files online. Making an extensive selection of audio content available for consumer use now would provide a convenient, genuine and legal alternative to piracy. Secure digital delivery systems will continue to improve over time, just as loss control systems at retail have improved over the years. Tower has long been a faithful partner in helping record companies combat piracy of physical goods all over the world. We believe we have earned the right to be trusted in the new digital distribution channel.

Tower can today offer downloads that are infinitely more secure than the music published on CDs. Every time a record company refuses legal content to Tower and other retailers, the result is that Tower and other retailers are prevented from competing with services like Napster. It seems illogical to us, and leads us to question

the motives of our suppliers. We worry that their long-teen plans may be to confine existing retailers to the “bricks and mortar” world while the record companies try to establish stronger technological controls not only over electronic distribution, but also over lawful use subsequent to the initial distribution.

Question: The premise of this hearing is that digital content is coming soon to digital devices to be enjoyed by consumers soon. Based on our discussion today, how soon is soon, and when will the promise become reality?

Answer: There is no technological barrier preventing that from happening right now. As I said in my testimony, robust technology exists to facilitate the portability of song files to a variety of media and playback mechanisms. We do acknowledge that there is the challenging issue of developing viable economic models for digital distribution. However, we believe that the best way to test the viability of these economic models is to work with trusted partners like Tower who will provide real feedback from real consumers about real products available in the marketplace.

Question: Is there any point you feel should be raised or that you would like to further respond to for the completeness of our record?

Answer: We are concerned that what is happening today has less to do with controlling piracy, and more to do with copyright owners controlling the distribution and use of copies and phonorecords beyond the limits imposed by Congress. The piracy rationale is not limited to music, but is being extended to motion pictures as well. See, e.g., Alen Koebel, “Digital Video Interfaces And Consumer Displays,” *Widescreen Review*, April 2001, p. 102, at 106 (“Digital technologies, for the first time, make it possible to control where, when and in what manner content is viewed. Digital content protection could be used simply to prevent copies, but is capable of much more . . . [and] the evidence suggests that Hollywood is actually more concerned with controlling honest consumers—with the ultimate aim of extracting more money from their wallets—than stopping pirates”).

Previously, when new technologies that “steal” copyrighted material have been introduced (like cable TV or video), Congress has sought solely to ensure compensation Congress has never sought to guarantee control. Copyright owners have never been permitted to decide who gets to sell copies and phonorecords, or to whom or at what price. Nor have copyright owners been permitted to decide who gets to read a book, listen to a song, rent or watch a movie, or whether the owner of a lawfully purchased copy can give it away. Today record companies and studios are attempting to claim the unlimited right to control these decisions. See “Report to Congress: Study Examining 17 U.S.C. Sections 109 and 117 Pursuant to Section 104 of the Digital Millennium Copyright Act,” U.S. Dept. of Commerce, National Telecommunications and Information Administration, March 2001, n.101.

Question: What are your concerns regarding the recently announced MusicNet and Duet deals, and what issues in connection with these deals should the Judiciary Committee, in your opinion, continue to watch?

Answer: Tower’s concerns are based in part on the fact that the details of these deals have yet to be made clear. It appears that MusicNet intends to offer streams and downloads. Their first customers will be AOL and Real Networks, both major stakeholders in the MusicNet stake company. Record companies tell us MusicNet is an independent company that will be non-discriminatory. Tower expects that the terms and conditions through which content is made available to us will allow us to compete just as aggressively against AOL and Real as we do against other retailers.

Our concerns also echo those of the Register of Copyrights, which offers that “any one work will ordinarily be competing in the market with many others . . . [t]he real danger of monopoly might arise when many works of the same kind are pooled and controlled together.” Register’s Report on the General Revision of the U.S. Copyright Law (1961), at 5. In the off-line world, the five major record companies have already formed crosslicensing relationships with each other that disfavor competing retailers, in a manner very similar to what appear to be the MusicNet/Duet deals. Record clubs like Columbia House and BMG Direct cross license audio content to companies owned by the record companies themselves, resulting in the ubiquitous “10 CDs for a penny” offers which not only dramatically reduce the perceived value of music generally, but which foster a belief among consumers that recordings retailers like Tower sell are overpriced. Online, MusicNet and Duet reflect the recognition of the record companies, voiced by Richard Parsons at the April 3, 2001 hearing and recently echoed in Time. “None of these services can survive without content from all five major labels.” Dannielle Romano, music analyst at Jupiter Media Metrix, as quoted in by Chris Taylor in “More Pain for Napster: The big music labels spin plans go to the Net,” Time, April 16, 2001, p. 43. Retailers, likewise, must have content from at least each of the major companies to be competitive.

Thus, the danger mentioned by the Register of Copyrights forty years ago has increased exponentially. Currently, five companies control 85% of all sound recordings. So, MusicNet and Duet will together control 85% of the market. Moreover, since neither MusicNet nor Duet can succeed on the strength of their own collections, it stands to reason that soon these two behemoths will follow the model they established with BMG Direct and Columbia House, cross license to each other, and each be in a position to dispense with having to deal competitively with any other competing distribution entity. See Learmonth, "Universal and Sony in Napsterless Harmony," *The Industry Standard*, visited at <http://www.idg.net/crd—music—450642—103.htm1> ("... sources say, Duet development has been launched; the staff is based in New York and its corporate structure will be much like the Columbia House record club, which is half-owned by Sony and half by Warner Music Group.") Independent record companies will be forced to accede to their terms if they want an outlet, and no retailer would have any hope of offering competitive terms to consumers because their wholesale costs will, as we have seen with the record clubs, be several times higher than the wholesale prices the record companies give each other.

As I mentioned in my testimony, many entities are ready to offer lawful digital downloads. Thus, the creation of MusicNet and Duet was not really necessary to achieve that objective. To the contrary, the evidence suggests that the reason these record companies have denied others the opportunity to lawfully compete with Napster by delaying secure digital downloads is that they hope to devise a network by which they alone can control substantially all digital distribution.

There are, then, two issues that Tower would ask this Committee to continue to watch. First, the degree to which companies that have amassed substantial collections of copyrighted works leverage the power of these monopoly collections into control over their competition. These companies have shown a historical predilection to monopolize online entertainment in ways both subtle and overt, and therefore, examining the reciprocal relationship licensing used to favor their own companies and joint ventures over those of their competitors, would be appropriate. See, for example, *Six West Retail Acquisition, Inc. v. Sony Management Corp.*, No. 97 Civ. 5499 (DNE), 2000 U.S. Dist. LEXIS 2604, *60-*64 (S.D.N.Y. March 8, 2000).

Second, the Judiciary Committee should continue to watch the same issue that was of concern to Congress nearly 100 years ago—striking the proper balance between content owners' legitimate demands for compensation, and yielding to their illegitimate demands for control. Today, there is every reason to stay the course explained by your colleagues in the House in 1909 when the House Judiciary Committee said: "Your committee feel that it would be most unwise to permit the copyright proprietor to exercise any control whatever over the article which is the subject of copyright after said proprietor has made the first sale." In the online world, this means that a copyright cartel must be prevented from controlling the retail-level authorization of downloads because the result of a digital download is the same as the purchase of a DVD or CD: The consumer will become the "owner of a lawfully made copy or phonorecord." See Section 109. Just as Congress prevents copyright owners from controlling distribution once having sold copies for distribution, so, too, should they be prevented from controlling retail-level DPDs once they have licensed a merchant to offer the DPD to the public.

Just as in the sale pre-packaged copies and phonorecords, the public interest demands that retailers remain free to charge competing prices, offer competing levels of customer support, and otherwise offer the public the benefit of vigorous competition. In the same manner, consumers must be free to give, sell or lend lawfully acquired songs. Congress should act swiftly in response to any use of new technology to prevent the lawful use of lawfully made copies, and should take the additional step of making sure that digital distribution of phonorecords made at home or in a retail store remains just as free from copyright owner control as is the physical distribution of pre-recorded phonorecords made in a factory.

Question: There have been calls for compulsory licensing of sound recordings, of publishing rights, and of "most favored nation" protections for online distributors not affiliated with record companies. Others argue that no one has rights to use property other than the property owner and those property owner agrees with (with fair use exceptions in the copyright context, of course). Could you each explain what justification you see, if any, for such extreme legislative action, other than that your business plans rely on using the major labels' content to be successful? Please be specific if you suggest such theories as misuse of copyright, etc.

Answer: While Tower does not favor compulsory licensing at this time, we believe a careful review of industry practices up to this point is helpful in evaluating two separate but related issues. One is whether the copyright owner should be obligated to license the online reproduction of its works, and the other is whether such licens-

ing, once authorized, should be given on a non-discriminatory basis. The effect of the copyright owner's decision upon freedom of competition is fundamentally different in an online or "postrecorded" distribution than it is for physical or "pre-recorded" distribution.

For the consuming public, the most important feature of physical distribution is not whether or to whom the reproduction right or distribution right is licensed, because at some point the goods will reach a retailer of the customer's choosing, should that retailer choose to carry the product. Moreover, thanks to the Robinson-Patman Act, all retailers will have roughly the same acquisition cost, and thanks to the first sale doctrine, all retailers will have a chance to buy the product and compete on a relatively level playing field.

In the online world, the strictures of the Robinson-Patman Act can be avoided because the courts have interpreted it to apply to the sale of tangible goods, but not to licenses. Free of the restrictions in the Robinson-Patman Act, copyright owners have the power to license the reproduction right to only those companies of their choosing and can also decide who will survive through the use of terms which favor one competitor (such as a company which they own) over another.

In short, in the physical goods world, the copyright owner may strategically restrict who can manufacture (reproduce) copies and phonorecords of its works, and who can make the initial distribution of its works, but the distributors must not discriminate in price and retailers to whom they refuse to sell will always have a way of obtaining the product for resale. In the online distribution world, in contrast, the copyright owner can *both* shut a retailer completely out of the market and/or license the reproduction right on grossly discriminatory terms, to the same effect.

A case brought by NARM against Sony Corporation, on behalf of its music retail members, challenges Sony's cross-licensing wherein the record clubs can obtain sound recordings identical to the ones retailers sell, but at a small fraction of the price. Sony claims that it can do this because licenses are not subject to the Robinson-Patman Act. In this case, which is currently before Judge Sullivan in the U.S. District Court for the District of Columbia, we allege that these licenses are in reality just sham licenses intended to cover up what are, in substance, sales of goods of like kind and quality to similarly situated buyers but at grossly dissimilar prices. The CDs are manufactured in the same manufacturing facilities and result in virtually identical copies. A CD Sony sells to Tower for \$12.50 costs Columbia House (the record club jointly owned by Sony and AOL/TW) only about \$2.50. The result is that Columbia House can make a \$10 profit before retailers can break even. If that same model is carried over to digital distribution (and every indication is that the record companies intend precisely that), then the retailers favored by the copyright owners could offer downloads at a small fraction of the "wholesale" cost offered to other retailers.

Do consumers benefit when two retailers are charged one wholesale price, and all others are charged 500% more? Clearly, they would be better off if thousands of retailers like Tower were charged the lower wholesale price.

Congress should adopt the same policy restrictions for copyright owners in the world of digital distribution as it did for physical distribution. "[W]here the copyright owner first consents to the sale or other distribution of copies or phonorecords . . . continued control over distribution of copies is not so much a supplement to the intangible copyright, but is rather primarily a device for controlling the disposition of the tangible personal property that embodies the copyrighted work. Therefore, at this point, the policy favoring a copyright monopoly for authors gives way to the policy opposing restraints of trade and restraints on alienation." 2 M. Nimmer & D. Nimmer, NIMMER ON COPYRIGHT, § 8.12[A] (2000).

Your question notes that some "argue that no one has rights to use property other than the property owner and those the property owner agrees with . . ." but such argument fails following a quick reference to the Copyright Act. There is absolutely nothing in the Copyright Act that creates any exclusive right of "use." Anyone can use a copyrighted work in any way they desire, so long as it does not infringe any of the enumerated exclusive rights. If I were to sneak into a theater to watch a movie without paying, I may be in trouble with the theater owner if I get caught, but I'm not infringing copyright. Similarly, a record company has no power under the Copyright Act to control who gets to listen to a recording.

There have been many business plans that have relied on using copyrighted content in ways that copyright owners may not have supported, but which have ultimately benefited them. Cable TV has provided thousands of additional outlets for content. MTV created a market for selling music video in addition to promoting the sale of millions of CDs. Independent video stores created both the video rental and video sell-through markets. The notion that an independent business plan that uses copyrighted material is somehow "tainted" should be treated with suspicion.

Question: I assume you agree that ultimately online distribution of music, be it downloads or streaming services, can be less costly than distribution in the physical world where trucks, warehousing, damaged goods, and overstocks can run up costs. Some have suggested that the labels cannot pass these cost savings on to consumers because doing so would upset the record store retailers they rely on like Tower Records by undercutting the record store sales price. Would you agree that brick and mortar retailers are the reason online cost-savings cannot be passed on to consumers? Similarly, would you object to retailers using deep discounts on recorded music as loss leaders to induce customers to visit the store, perhaps to buy stereo equipment, etc., and if so, why?

Answer: We agree that online distribution of music *may* be less costly than distribution in the physical world. We do not agree that brick and mortar retailers are the reason that online cost-savings would not be passed on to consumers. First, let us clarify the use of the term “distribution,” which refers to the wholesaling of music, and which is distinct from “retailing”, which involves selling to the end user. Today, if Tower buys 1,000 CDs, they would have to be manufactured, labeled, packaged and shipped to our stores. Tomorrow, Tower could obtain one digital file and a license to sell 1000 Tower customers the rights to download a copy. For the record company, the latter form of distribution is certainly cheaper because the costs of manufacturing the components of a recording are being shifted downstream.

If lower wholesale prices result from economies realized in online distribution, and if they are commensurate with the actual savings, we see no reason to be upset. The cost of producing the recorded media, printing the booklet, inserting the CD and booklet in a package, boxing, shipping and maintaining the necessary warehousing, sales and inventory systems and personnel as well as any other physical-world-only materials and activities could be reasonably deducted from the existing wholesale cost. However, there are other activities which must reasonably replace them such as storing and serving the content in a secure server, utilizing a copyright management system, verifying the completion of the download, and providing customer service for incomplete or faulty downloads. Once these are added back in, along with activities which do not change, such as advertising and promotion, we will be able to determine the true savings that might be passed on.

As long as the cost-basis of merchandise is consistent and supported by reasonable volume requirements and other accepted marketing programs such as dating, advertising support, and merchandising support, we would embrace lower costs online. What record companies are really describing when they say brick-and-mortar retailers will object to passing on savings are the “savings” they intend to reap by eliminating retailers from the distribution chain altogether.

We are concerned that record companies will create direct marketing strategies that mirror those in the record clubs, where cross-licensing and sweetheart licenses are granted only to affiliated companies. These arrangements in the past have eroded the perceived value of music and lead consumers to believe retailers are making dramatically greater profits than they really are.

We define a “loss leader” as a product that is sold for less than its actual cost. We do not object to low margin “deep discounting,” per se, as a means to induce customers to visit a store to buy other, more profitable products, and while we think pricing below cost is bad public policy and we don’t engage in it ourselves, we recognize that some of our competitors do. However, consumers as well as government need to understand the true impact of loss leader programs on the ecosystem of bringing, and keeping, music widely available to the public. Tower has always been devoted to finding and stocking every piece of music offered to us, and to having personnel who are knowledgeable about such a vast selection of music. The cost of such an approach is substantial, and therefore we place less emphasis on having the best price in our marketing. However, our concerns about the impact of widespread loss leader programs extend well past the impact on Tower’s marketplace niche.

Particularly in this age of dot-coms, when the cost of new customer acquisition may exceed the wholesale price of two or three CDs, it concerns us when CDs are sold below wholesale because the company in question is not really in the business of selling music at all, but in the business of selling advertising or in selling consumer data, in which case the lure of cheap music may be used as the bait to engage in lucrative consumer data mining, or to solicit for sales of unrelated consumer goods. Such activities undermine the value of music, both real and perceived, and tend to undermine what should be one of the primary sources of income for creative artists.

Sometimes our issues dovetail with those of others in the value chain, like artists. Why should an artist forgo regular royalty levels to enable a record club to use these strategies to erode the value of their work? Why should a record company be per-

mitted to reduce the artist's compensation for an identical consumer product, just to undercut the competing retailer? And, how does the consumer benefit when a purported cost savings is made possible by shifting the cost from one retailer (the one in which the record company has a financial interest) to another (that competes independently)?

The short answer to your question, then, is that retailers fear the lack of true competition more than we fear true competitors. The Copyright Act makes a careful distinction between the copyright in the intellectual property, which grants a limited monopoly, and rights in the copies and phonorecords themselves, where the free market and antitrust laws come into play. See Section 202 ("Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied"). When the copyright monopoly in the intellectual property is used to restrict competition in the physical property (whether made in a factory, store or home), Congress should provide the tools with which the courts can draw the line. In this, we echo the concern raised by Senator Hatch when he stated: "We will also need to review the increasing legal tension in the high technology industry between intellectual property rights and antitrust laws. There has always been a tension here, but in the Internet world, we need to be careful that intellectual property or content power is not leveraged into distribution power, or otherwise used in anticompetitive ways." 107 Cong. Rec. S 1376 *et seq.*, February 14, 2001).

RESPONSES TO WRITTEN QUESTIONS FROM SENATOR LEAHY

Question 1: Mike Farrace, Senior Vice President, at Tower Records testified that some record companies are requiring personal data from and about Towers' customers, prompting concerns by Tower Records about violating its own privacy policy, damaging the relationship with the customer, and "maybe even result[ing] in Tower violating the law."

Question 1(A): What sort of personal data are record companies requesting from retail distributors, such as Tower Records, and other online distribution services to provide from or about customers?

Answer: The customer's e-mail address is the primary bit of data labels want, although some proposed systems require much more. Record companies have used several strategies to acquire the email address and other information, which we outline in Question 1(B).

Question 1(B): Are record companies asking retail distributors to provide any personal data about customers who purchase CDs in brick-and-mortar stores, or have the requests for collection of customer data been limited to online music purchases?

Answer: Record companies have solicited personal retail customer data in both selling environments. They have long sought customer data through the use of "blow in" cards which invite a CD purchaser to complete a form in order to join a fan club or get additional information about a company's catalog of releases. Some record companies embed links on CDs sold at brick and mortar stores which link to record company-owned artist web sites, which in turn link to record company-owned commerce sites, or to third party commerce sites. Manufacturers have not yet specifically requested or required that Tower provide personal data about brick and mortar customers who purchase CDs to them directly. However, they do routinely print the URL's of artist and label sites on the product, so we are forced to market their data collection web site and, ultimately, their own or third-party commerce sites. It is as though instead of requiring that we give them our best customer list, they simply forced us to send everyone on that list free advertising for their competing retail site.

Online, record companies have variously proposed several systems that have inherent data collection, and/or systems which have "opt in" screens intermingled with the transaction process, but email data can be gathered under a variety of circumstances.

In the first, the record company's digital delivery system processes the transaction. In these systems, the label captures the consumer's e-mail address, specifics about the product purchased, the customer's credit card number, dates, times, etc. This information can then be combined with prior purchases to determine trends and create user profiles. This is the most objectionable situation for retailers.

The second strategy is to insert an "opt-in" screen during the transaction process. In some cases, this has been a simple screen that asks for the customer's email address without explanation. In others, text below the entry field asks the user if they would like more information about this artist. In some cases, the name is simply gathered by the content owner and no particular use of the name is specified. In others, the user is sent to a web site where they are presented with a large list of

artist names with checkboxes, and told they will receive email about the artists they checked.

The third strategy is one in which the record company partners with a technology company to offer their own customer support function, and in which the technology company will collect consumer data at the customer support level and share it with the record company.

The fourth is one in which the record company limits the retailer to the role of sales agent, wherein the online retailer's only function is to promote links to the record company itself and perhaps handle the customer support function if the transaction fails. The consumer transaction is made directly with the record company (though the consumer may not be aware of it) in exchange for a commission to the retailer/sales agent, and thus the record company can solicit whatever information it wishes without regard to the retailer's wishes or privacy policies.

We do not object to opt-in opportunities generally. We do object to the use of these names by record companies for marketing directly to Tower consumers. Only one label that does not already require personal data as part of a proprietary transaction mechanism, EMI, has agreed to refrain from activities of this kind. Some companies have offered to share the names under certain conditions, or agree to mail only in conjunction with the primary retailer, or to allow the retailer to email, provided the retailer does the mailings whenever the record company wants and/or agrees to limit the content of the emails.

The problem with these scenarios is twofold: (1) Because there are multiple retailers and multiple content owners, customers could potentially be barraged by numerous indiscriminate mailings, which will create customer service burdens to retailers and, as a result, undermine each retailer's customer relationship. (2) Of equal concern is that we know that information about Tower customers will be used to eventually divert future purchases from our customers to retailers owned or operated by the record companies. Other than EMI via the agreement with Liquid Audio, no record company will promise never to use the data independently unless we agree to conditions like the ones above.

Most labels also want recaps of sales, including artist, title and sales price. We don't object to sales recaps when they are used in aggregate to discern trends, identify "hot" records or for other purposes consistent with building marketing plans that intelligently allocate resources to resellers. We do object when our own customer information is used to market to our customers, or is used by the recipients to compete with us. It frustrates free market economics by using monopoly power to raise the costs to a competitor.

(The use of embedded hyperlinks as described above is part of a lawsuit filed by the National Association of Recording Merchandisers, the music retailer trade organization to which we belong, against Sony Corporation.)

Question 1(C): Are retail distributors and online distribution services formulating or revising their privacy policies to accommodate requests from record companies to provide personal data from or about customers?

Answer: Tower's privacy policy requires explicit permission from our customer to send email beyond order acknowledgements, confirmations and receipts. Opt-in opportunities exist on our site, and are included at the bottom of these transactional mailings. We are concerned that we do not know exactly what information our suppliers or their agents may be collecting or what they may be doing with the data. We have not revised our privacy policies to accommodate labels, preferring instead to fight for our customers' privacy as well as for the exclusive ownership of the existing retail relationship, including customer contact information. We are willing to cooperate with record companies, as we always have, in marketing recordings. For example, in return for dropping record company requirements to possess and use our customer information, we have offered to feature their products in a guaranteed number of periodic emails executed by mutual agreement on behalf of their artists.

On the video side of our business, we are fortunate that Congress enacted the Video Privacy Protection Act, 18 U.S.C. §2710, which prohibits such data mining without the contemporaneous consent of the consumer. The courts have held that third parties who obtain such information may also be liable for the disclosure. This was the determination reached in *Video Software Dealers Association, Inc. v. City of Oklahoma City*, No. CIV97-1150-T, 1998 U.S. Dist. LEXIS 22095 (W.D. Okla. Dec. 18, 1998), a case brought on behalf of retailers such as Tower by our trade association. Because of this law, our customers' private video sales and rental records cannot be surreptitiously taken from us.

Question 1(D): Are record companies requiring as part of their licensing agreements for digital music that they be provided access to customers' personal data?

Answer: Yes. As described above, some licensing agreements include the use of delivery systems that automatically deliver customer data to record companies preempting the need to have “access.” They get the customer personal data as part of the transaction, and do not pay for the information or even negotiate with us for access. As in the case of hyperlinks on CDs, retailers simply do not have an alternative if they want the content.

Question 2: Jack Valenti testified that within four to six months, several movie studios plan to use the Internet to transmit movies to American homes in encrypted form, but that more protection may be needed, “some of which might require congressional legislation.” In the Digital Millennium Copyright Act (DMCA), the Congress has provided protection for technological measures that effectively control access to copyrighted works and barred the manufacture, import or sale of products or services primarily designed to circumvent such technological measures. 17 U.S.C. § 1201(a)(1) & (2). Please describe the circumstances where additional protection may be warranted and the areas not already covered by the DMCA where additional legislation may be requested.

Answer: Mr. Valenti’s statement is open-ended. While we support all ongoing efforts to restrict the illegal copying and distribution of copyrighted works, we do as long as they do not create onerous limits on fair use, or require that retail customer data be turned over to copyright holders. That said, Tower does not foresee a future need for additional legislative protection. Indeed, it appears that technological developments alone are now replacing the Copyright Act as the greatest source of power for copyright owners, such that Congress may need to address restoring the appropriate public/private balance in copyright law rather than creating greater protections for copyright owners. As noted by Alen Koebel, supra, this may be more about controlling lawful use than controlling piracy. The new prohibition on circumventing effective access control technologies “must be weighed against the potential for misuse that content protection brings.” Koebel at 106.

Question 3: Concerns have been expressed that “copyright management” measures being developed by copyright owners to control the distribution of their digital works may erode the first sale doctrine. If a customer pays for the personal use of a copyrighted work, the rights holder may use technological means to ensure that the work is not posted on a web site for use by others. Do you believe that the marketplace will sort out the scope of copyright management measures since customers who believe they are not getting what they pay for will simply stop buying?

Answer: We support copyright management measures which limit illegal distribution of digital works while still providing an acceptable end-user experience and respecting the rights copyright law gives to owners. We object to the use of so-called “digital rights management” (or “DRM”) systems and other access control technologies which have little to do with copyright management, but are, instead, being implemented in ways that prevent consumers from exercising Section 109 rights.

We believe that access control technologies are already proving to be unacceptable to consumers because of the severe restrictions to legal use imposed after the sale. Since resellers are being forced to pass on such restrictions (as we have no control over them and it is unlawful to circumvent them), the record company restrictions become unreasonable barriers for resellers in their efforts to market digital content. The marketplace cannot sort out the use of restrictive measures because the copyright monopoly is being used in conjunction with the prohibitions in Section 1201 to prevent the normal market effects to sort this out. For example, copies of motion pictures are being offered through digital download using DRM technology that prevents the owner of the lawfully made copy from renting, lending or selling it. That is, the technology prevents owners of the download from exercising their rights under Section 109. The download of the Miramax film *Guinevere* is one example. The consumer who downloads the film becomes the owner of a lawfully made copy, but can only enjoy the copy for a 24-hour period, after which access is denied unless an additional payment is made. If consumers object to the terms contained at the single retail site from which it is available (www.sightsound.com), there is no other place to which the consumer can turn for better terms. Thus, the consumer only has the choice of giving up their rights guaranteed by Section 109 or never owning the download.

If we consider, however, how a competitive market might sort this out, the result is completely different. Section 109 limits the right of copyright owners, not retailers. If a retailer were to offer the downloaded copy with similar restrictions, consumers who object to such terms could simply shop elsewhere, just as today, a consumer who objects to having to return a rented video the next day can shop with a retailer who offers longer rental periods, or the consumer can purchase it outright.

We believe customers will pay for reasonably secured content that is reasonably priced. The question is, "Is what they want to buy being offered, and if not, why not?" A competitive retail market would normally charge a lower price for a product with added restrictions on use. What we are seeing in the digital music industry, even in the prerecorded media, is added cost (that is, added restrictions) with no countervailing price reduction. When Sony added a restrictive EULA to one of its CDs, there was not a penny of price reduction. According to Sony, the consumer who failed to return the CD to Sony within seven days of purchase agreed never to sell it, lend it or give it away, and agreed never to play it on a different computer, yet there was neither a price reduction in exchange nor an option to purchase the CD elsewhere without the restrictions. (See Attachment A to my written testimony.) Retailers could not compete to offer the CD with or without the restrictions, and therefore the marketplace will never have the tools with which to sort out the most competitive scope of access control technologies. Only illegal distribution sites are in a position to offer a competitive choice.

The only way for the market to sort out the appropriate scope of copyright management measures is for the use of such measures to be strictly limited to the management of the copyrights set forth in Section 106, as further limited by the Copyright Act and, in particular, Section 109. When copyright owners leverage their monopolies to "manage" rights they do not have (such as to control how the lawful owner disposes of a lawfully made copy), the free market is subverted, competition is suppressed, consumers lose out, and artists gain less exposure.

Question 4: Retailers of music, movies, video games and other copyrighted works have expressed concern about whether copyright management measures and end user licensing agreements will erode the ability of retailers and distributors to distinguish themselves from one another in meaningful ways with the potential of stifling competition among retailers, since those measures may set uniform prices, policies and terms for the online distribution of digital works.

Question 4(A): Please explain whether you believe that uniform copyright management measures and user licensing agreements carry the potential risks for competition identified by retailers?

Answer: It is not just the uniformity, but also the oppressiveness of these measures that give rise to our concerns. We believe copyright management measures and user licensing agreements, to the degree that they preserve first sale rights and provide resellers with opportunities to sell their customers digital works in the form customers want, do not carry undue risks inherently. It is the degree to which copyright owners restrict access and use outside of the bounds of their copyrights, to fix retail prices, suppress retail competition, or use such access controls to gather and use our customer information, that present the risks. The uniformity itself is a symptom of the lack of retail competition, and an element detrimental to consumers (as it is any time all stores look alike), and to retailers, who have fewer significant ways in which to compete. The need for us here at Tower to distinguish ourselves from our competitors is not just a desire to maintain our unique personality, character and reputation, but is the essence of the way we compete. We can't claim to be better than the store down the street if we are prevented from being better.

Question 4(B): Would variation in the terms for pricing, use policies and terms for the distribution of digital works provide flexibility for different distribution models and give the consumer the maximum number of choices?

Answer: Absolutely, provided that these variations are the result of retail competition and not the result of the copyright owners discriminating among competing retailers. Some of the most innovative business models giving consumers the most choice are those that are beyond the control of the copyright owner. For example, without (and indeed against) the consent of the copyright owner, consumers can obtain pre-recorded copies and phonorecords new from a store, free on loan from the library or a friend, second-hand at a used goods store, a yard sale or flea market, at a low-cost rental in the case of movies and video games, or as a gift. We at Tower consider competing with these avenues part of doing business. The fact that our customers can re-sell, loan or give away what they buy from us adds value to that initial purchase transaction, even though neither we nor the copyright owner derive any additional value from the myriad possible subsequent distributions.

The best business model we have today is where they sell us the copies at a price of their choosing, and we in turn market them and develop all sorts of competing ways of getting them into the hands of consumers, who are free, in turn, to legally transfer title or possession to others. That's how it should work for digital downloads. Once someone else owns the downloaded copy, the copyright owner's control over that copy should cease. Let others compete over the pricing and distribution terms, so consumers will have some real choices.

Question 5: The Copyright Office issued a Notice of Inquiry on March 9, in response to a petition by the RIAA, stating that: “there is considerable uncertainty as to interpretation and application of the copyright laws to certain kinds of digital transmissions of prerecorded musical works. It is also apparent that the impasse presented by these legal questions may impede the ability of copyright owners and users to agree upon royalty rates under section 115. . .” 66 Fed. Reg. 14099, 141101 (2001).

Question 5(A): Do you agree with this statement and, if so, please explain how the uncertainty over the legal questions presented in the petition are affecting voluntary licensing agreements for new online music services?

Answer: It appears to us that much of what passes for uncertainty is, in reality, the result of an effort by various interest groups to advance a position which stretches copyright law in a direction more favorable to them. Perhaps it is not so much the uncertainty that is affecting voluntary licensing agreements, but the positions that are being staked out as part of a negotiating posture.

Question 5(B): In 1995, the Digital Performance Right in Sound Recordings Act expanded the scope of the mechanical license, under 17 U.S.C. § 115, to include the right to distribute, or authorize the distribution of, by digital transmission both hard copy phonorecords and “digital phonorecord deliveries” or “DPDs.” DPDs are defined in the Act but a subset of DPDs, called “incidental DPDs,” which are also subject to the mechanical licensing process, are not defined. One of the issues before the Copyright Office is to determine what is and what is not an “incidental DPD.” Is this a question that the Copyright Office or the Congress should determine in the first instance?

Answer: To a large extent, this issue may have been addressed more effectively than Congress realized back in 1976, when it revised the basis for calculating the royalty rate to provide that “the royalty under a compulsory license shall be payable for every phonorecord made and distributed in accordance with the license.” Section 115(c)(2) (emphasis added). House Report No. 94-1476 explained: “It is unjustified to require a compulsory licensee to pay license fees on records which merely go into inventory, which may later be destroyed, and from which the record producer gains no economic benefit.” (Let’s call them “incidental phonorecords,” by analogy.) It was Congress’ intent “that the Register of Copyrights will prescribe regulations insuring that copyright owners will receive full and prompt payment for all phonorecords made and distributed.” *Id.* (emphasis added). Moreover, as noted in said Report, Section 115(c)(2) further provides that “a phonorecord is considered ‘distributed’ if the person exercising the compulsory license has voluntarily and permanently parted with possession.” Finally, the Report stresses that the term “made” was used instead of “manufactured” so as to include “every possible manufacturing or other process capable of reproducing a sound recording in phonorecords.”

It appears to us, then, that Congress already determined this issue in the first instance. Certainly DPDs are one possible “manufacturing or other process capable of reproducing a sound recording in phonorecords.” (Even a computer hard drive can be a “phonorecord,” as that term is defined in Section 101.) Further, Congress has already empowered to Copyright Office to insure that prompt payment is made for DPDs that are “made and distributed.” Just as no royalty obligation would be triggered by “incidental phonorecords” from which the producer gains no benefit, logic would dictate that “incidental DPDs” which serve only to facilitate efficient distribution of the actual DPD would trigger no compulsory license royalty obligation. Congress has delegated to the Copyright Office responsibility for determining when the royalty payable for actually distributed DPDs becomes due.

Question 5(C): The Copyright Office is currently considering the applicability of the section 115 mechanical license to two new services for delivery of digital music: “On-Demand streaming” (which permits users to listen to real-time streamed music they want when they want it) and “Limited Downloads” (which permits users to download music for listening for only a limited time). According to the Notice of Inquiry, these types of services were not “anticipated” when the Congress expanded the scope of section 115 to cover digital transmissions. Is legal uncertainty over the applicability of section 115 to these new services having any effect on the deployment of such services and, if so, please explain what that effect is?

Answer: As for “On-Demand streaming,” we agree with the comments of the Consumer Electronics Association and Clear Channel Communications, Inc., filed on April 23, 2001, in response to the Copyright Office’ Notice of Inquiry, 66 Fed. Reg. 14,099. We do not see how a public performance could possibly generate a mechanical royalty. A DPD could be made concurrent with a public performance, but in that case, the mechanical license is triggered by the DPD, not the public performance.

“Limited Downloads” are not recognized under copyright law. What is being sought by the RIAA from the Copyright Office is power to authorize the reproduction and distribution of a copy of a work, only to have the resulting copy time out or otherwise be rendered useless to its owner. We can see no room for such an approach, particularly given the rights of owners of lawfully made copies to dispose of them without the copyright owner’s consent. The proposal would allow the use of access control technologies to effectively lock out the owner of a lawfully made copy from continuing to enjoy the fruits of ownership.

The RIAA proposal may be consistent with the position of the Copyright Industry Organizations, which maintain that Section 109 rights may be exercised only “in the absence of licensing or technological restrictions to the contrary.” But surely Congress never intended the rights in Section 109, which specifically limit the copyright monopoly, to be taken away by the copyright owner’s own use of technological access controls. A logical extension of such concept would prevent the public from re-reading books, borrowing books, purchasing them used, or receiving previously read books by gift, because they would be unreadable.

So the question is not whether legal uncertainty over the “Limited Download” is having an effect on the deployment of such a “service.” The question is whether Congress should make it even clearer that a Limited Download as a tool used at the sole discretion of the copyright owner is not a “service” to consumers, but an unauthorized extension of the copyright owner’s control over lawfully made copies which are the property of others.

On the other hand, we are more than willing to explore how technology can be used to extend the number of options available for disseminating works. Rep. Boucher introduced legislation during the last Congress to allow owners of lawfully made copies to forward them to others if the original is deleted, but without infringing the right of reproduction. The use of “check-in/check-out” technology to allow consumers to redistribute a digital file while ensuring that only one authorized copy is accessible at a given time sounds very attractive, and we are pleased to be working with copyright owners and technology companies to support industry standards for such actions. In the very near future, Congress should carefully consider how copyright law should evolve to facilitate such business models, but now is not the time to be fitting a square peg into a round hole.

In the motion picture industry, limited use is a service provided by your local video store—not the copyright owner. (Videos can already be rented online, even though the delivery is still through the mails.) In the event that Congress visits this issue, we would suggest that the analogy be drawn from the physical distribution world, where copyright owners are prevented from using their monopoly to control distribution. For example, a library might have the right to “lend” an electronic copy by letting a patron download the file to their computer while the original is rendered inaccessible. Or the library might “own” the virtual right to three copies, but only have one actual copy, which could be downloaded by up to three patrons at a time. The “check-in” technology would allow the patron to “return” the copy, in which case the original is made accessible again and access is denied to the patron’s copy. Such a model could be used for video rental as well. Under current law, each copy made implicates the reproduction right, regardless whether it is accessible. If copyright law were to be amended to support such functions without infringing the reproduction right, we feel it would be imperative for the physical distribution model to be followed. That is, just as selling, giving, library lending and video store rentals do not require the copyright owner’s consent, so, too, should the virtual equivalent remain outside of the control of the copyright owner.

If, indeed, an “online rental” model is to ever be recognized in copyright law, it should be developed along the lines of the physical goods model by an Act of Congress, the principles of the first sale doctrine should be maintained, and the rental terms should be determined by competing retailers rather than the copyright owner.

The Limited Download proposal also concerns us because one of the justifications for it is a promotional use of consumer sampling—a use for which the Copyright Act already makes ample provision. First, there is the in-store play exception contained in Section 110(7). This allows consumers to listen to an entire album in the record store. Second, the fair use doctrine allows what has been the industry practice since the inception of electronic commerce, and that is to permit the merchant to promote the sale of prerecorded works and downloads by offering song samples, normally lasting only about thirty seconds, or representative excerpts of a motion picture, commonly referred to as movie trailers, at the point of sale and without the need to first obtain permission. Just as booksellers may display copies of books open for perusal without fear of violating the copyright owners exclusive right of public display, and just as the grocer may reproduce copyrighted labels of soup cans in the Sunday newspaper to advertise the next week’s sale without violating the copyright

owner's exclusive right of reproduction, so, too, can music and video retailers copy and make available cover artwork, a thirty-second sound clip sample, or a movie trailer, to assist and encourage the consumer in making a purchasing decision

This is, in fact, very simple, and it concerns us that this effort to take what has been a standard no-cost industry practice and convert it into a new exclusive copyright called a Limited Download is coming at the very same time that several copyright owners have, almost in unison, begun asking retailers to get a license from them to promote the sale and rental of their works by use of such simple consumer-friendly devices. We can't tell whether this is sheer coincidence or part of a carefully orchestrated plan to further encroach into the domain beyond the reach of their copyrights but, either way, it is making retailers very nervous. The legality of this promotional activity in digital distribution should be affirmed in the law.

Question 5(D): Various music publishers filed suit in December, 2000, against UMG for copyright infringement alleging that UMG was copying sound recordings on servers for its new online music subscription service, Farmclub.com, and stating that: "UMG recently obtained a judgment from this court that the operator of another Internet music service, MP3.com, Inc., had willfully infringed UMG's sound recording copyrights by placing copies of those sound recordings on its public servers—precisely what UMG has done here without plaintiffs permission." Would clarifying the scope of the mechanical license under section 115 of the Copyright Act in the context of such new online music services help avoid the undue delay and undue distraction from litigation?

Answer: Yes. We believe that some clarification might be in order. It would appear that reproducing a sound recording onto the hard drive of a file server for the purpose of offering digital performances to the public would be an act of infringement unless some exception applies (such as in Section 107 or 114, for example). It should be equally clear that reproductions incidental to the delivery of an audio stream or digital downloads, but that have no independent value and cannot be perceived by the consumer, should not trigger the mechanical royalty. (See Section 115.)

Somewhere between these two rather clear issues (though we concede that some might debate them), are practices which may make perfect business and common sense from the standpoint of creating greater efficiencies for the benefit of consumers and copyright owners, but where the law did not anticipate the many recent improvements in digital distribution technology which depend upon the creation of multiple copies incidental to the actual public performance or DPD.

The best example I know of is the very practical need for making multiple copies of a work just to have available the most popular formats and CODECs. A merchant who is preparing a database of licensed song files for the purpose of offering lawful downloads or licensed audio streams should not have to pay more just for the ability to offer the consumer a choice of format, CODEC or transfer speed. That is like requiring a printer to pay extra for typesetting a large font version of a book for the vision impaired.

Question 6: Hillary Rosen has testified that RIAA member companies have committed to licensing Napster once the service operates in a fashion that respects copyrights and Napster has an agreement with Bertelsmann to help develop this system. What is the current status of Napster's efforts to develop a technological upgrade to digital rights management system that is secure and addresses the needs of artists and copyright owners addresses the rights of artists and copyright owners? Has Napster been able to share a new technological approach with (a) the court; (b) with artists or (c) with copyright owners? When does Napster expect to be able to introduce the new technological model?

Answer: I have no comment in response to this question.

Question 7: The record companies have announced new online music services, including MUSICNET and Duet, which will provide competing business-to-business platforms for music subscription services that will cross-license music and offer the services on a non-exclusive basis. As Hilary Rosen stated in her testimony, the record companies recognize the need to "ensure that online distribution enhances rather than undermines the commercial viability of our retail partners." Thus, the non-exclusive nature of these new platforms is important. Do you believe that it is also important for the record companies to make digital music available to those competing retailers capable of offering secure and accountable downloads, on a non-discriminatory basis that does not price them out of any competitive opportunity or give them substantially less attractive nonprice terms?

Answer: Yes, we do. We believe it is critically important for the record companies to make digital music available to competing retailers capable of offering secure and accountable downloads, on a non-discriminatory basis that does not price them out of any competitive opportunity or give them substantially less attractive non-price

terms. The same is true in the case of audiovisual works, and requires that we pay special attention to similar ventures in the motion picture industry such as MovieFly.

We also feel compelled to point out that we think non-discriminatory means offering these digital products equally on all levels, including at the same time, for the same price, with equivalent terms and conditions (such as warranties and replacement policies), and with the same bonus features (such as free promotional tracks or special added content).

To date, there have been announcements about the services, but no contact with retailers that we know of by Duet, MusicNet or any record companies about the planned new services. Nor have MovieFly or the motion picture studios been open to retail competition. Instead, announcements concerning their non-retail partners were made, with no mention of retail, which seems curious in light of Ms. Rosen's remarks about the importance of retailers to her member companies. The importance of retailers seems rather like that of a parasite to its live host, and reminds me of the analogy NARM drew to witchweed in its case against Sony, where it explained that "Witchweed (STRIGA ASIATICA) is a parasitic plant that attacks some of the most important crops in the U.S. . . . Unlike most weeds, which merely compete with crops, parasites like WW do their damage more directly. They rob nutrients and moisture by tapping directly into the host's root system. Consequently, the host spends energy supporting WW growth at its own expense." Fact Sheet for Witchweed (WW), FACT Sheet 07 PPQ, made available through the Cooperative Agriculture Pest Survey program, May 25, 1993, <http://ceris.purdue.edu/napis/pests/ww/facts.txt> accessed April 21, 2000. According to "Parasite," Microsoft Encarta Encyclopedia 2000, it eventually kills the host. And that is exactly how retailers are beginning to feel. We are an integral part of the industry which has resulted in the success of record companies, movie studios and computer game manufacturers, yet our root system—which is our customer base—is being tapped in an effort to feed off of it until we are no longer needed. They can't live without us, just yet.

The last contact we had with MusicNet was a meeting where nothing remotely similar to their press release the day before the Senate hearing was even mentioned. There has been no contact with Tower regarding details of the offers from either MusicNet or Duet, much less any offer from the record companies to invite us to compete with either of the two entities they jointly control.

RESPONSE TO WRITTEN QUESTION FROM SENATOR KOHL

Question: While all of the panelists are primarily concerned with access to online entertainment marketplace, they must also understand that they have a responsibility to parents. The Internet makes it even more difficult for parents to police the songs that their children hear, the images that they see and the games that they play. I'd like the panelists to discuss what their company or industry plans to do to help parents as online entertainment becomes more readily accessible to all consumers, especially children.

Answer: We are proud of what Tower is doing in this area. We met with the RIAA in February at the NARM convention, agreed with their recommendations, and have initiated a project with our online merchandising team which will improve the current notification which we implement online in the following ways:

1. Clearer language indicating parental advisory titles. We intend to use the terms, "Unedited, Explicit Lyrics" to describe such titles in place of "PA," or "explicit" to describe unedited recordings, and "Edited Lyrics" to describe edited versions.
2. Links to descriptions of what the language means. We intend to implement a web page describing what the terminology above means.
3. Persistent notification throughout the transaction process. While we haven't decided exactly how, we are working on methods to keep the Parental Advisory message "live" right through to the shopping basket.

You also asked about what our industry is doing. Tower is a member of two trade associations that have taken leading roles in this area. The National Association of Recording Merchandisers ("NARM") is the principal trade association for retailers and distributors of sound recordings, and the Video Software Dealers Association ("VSDA") is the principal trade association for retailers and distributors of home video movies and video games. As an active member of each, Tower has had the privilege of having a representative on the Board of each of these trade associations, and has participated in the development of our industry's programs in this area.

I must note, however, that despite challenging all members to be responsive to public concerns, both trade associations have been careful to preserve the freedom of each member to remain competitive with other members when it comes to dealing

with their customers. Each retailer sees customer relationships as one of the key areas in which we all compete with each other, and attempt to distinguish ourselves as the retailer most responsive to consumers, including children and their parents. How we do that is, ultimately, something we, at Tower, work very hard on independent of what any competing retailer may do. So, although industry-wide programs such as those NARM and VSDA have initiated have a very important function, we recognize that there are some areas in which freedom of competition is the best solution. When push comes to shove, as it often does in the competitive retail level of distribution, we want customers to choose our store over any competitor's, and if a younger customer needs their parent's permission to shop with us, we certainly want every parent to feel confident that their permission should be granted. That is one reason why we have so vigorously opposed proposals that would give our suppliers permission to enter into agreements in unreasonable restraint of trade against us. After all, as my responses to the previous questions make clear, they are becoming our fiercest retail competitors, and we cannot afford to let them have any additional control over retail distribution.

CONCLUDING STATEMENT

I respectfully ask the members of this Committee to consider whether you ever became fans of a particular artist because someone shared their copy of the music with you. I suspect that each of you can recall an occasion in which an artist's work touched you, even though someone else paid for the copy of the sound recording you heard. All of you have probably enjoyed the freedom to rent a movie instead of buying it. Yet, these opportunities are currently being threatened by technology. This debate should be more than about whether a record company may restrict distribution and redistribution to increase its profit from an artist's work, or whether a movie studio may use technology to prevent retailers from renting copies if their profit margins will increase. Rather, this debate should be about how "the Progress of Science and the Useful Arts" (U.S. Constitution, art. 8) can be promoted for the public good. The profits of the Copyright Industry Organization members, retailers and authors should be subservient to that end, and we think that end is best served by preserving our freedom to aggressively and lawfully compete in disseminating these treasures to the public.

Thank you for the opportunity to participate in this important debate.

Responses of Mark Traphagen, on behalf of InterTrust Technologies Corporation, to questions submitted by Senators Hatch, Leahy and Kohl

I have heard a number of entertainment companies say that acceptable protection for online content simply does not exist yet, that existing Digital Rights Management and watermarks, wrappers, or encryption, is simply not good enough to protect valuable content. Yet we have a number of technology companies here today who believe that they have such a solution, and now we have announcements of online initiatives from all five major labels, which suggests the technological protection have developed recently. Would any of you care to comment on the state of technological protection for content?

RESPONSE BY INTERTRUST:

The DRM technology developed by InterTrust is now capable of securely managing rights in copyrighted works—music, video, text, and graphics—in the online environment without compromising the rights of artists, record labels, and other copyright owners. Indeed, a number of entertainment companies (including AOL Time Warner, Bertelsman, and Universal Music Group), entertainment distributors (including Blockbuster), and entertainment device manufacturers (including Diamond Rio, Samsung, Nokia, and Philips) are actively working with InterTrust DRM technology to make music video, published text and other information products available for consumers to use on PCs, portable music players, cable systems and mobile phones.

Unlike simple technological measures that carry copyrighted works from a server to a client and lock the copy to a single device, the InterTrust DRM technology protects copyrighted works regardless of the channel through or platform upon which the music is played, the number of intermediaries, the duration of time, or the physical location of the content. This post-delivery, persistent protection of copyrighted works permits alternatives in making copyrighted works available, including sale of

downloads, subscriptions, pay-per-use and peer-to-peer distribution. It also provides flexibility for each actor in the distribution channel, meaning that a publisher can establish the commercial terms for a work within the authority granted by the author; a distributor can set rules within the scope of authority granted by the publisher, and so on. Because the copyrighted works are persistently protected by the InterTrust DRM technology, it also permits flexible use of these works by consumers using different devices in different locations.

QUESTION FROM SENATOR LEAHY:

Concerns have been expressed that “copyright management” measures being developed by copyright owners to control the distribution of their digital works may erode the first sale doctrine. If a customer pays for the personal use of a copyrighted work, the rights holder may use technological means to ensure that the work is not posted on a web site for use by others. Do you believe that the marketplace will sort out the scope of copyright management measures since customers who believe they are not getting what they pay for will simply stop buying?

RESPONSE BY INTERTRUST:

InterTrust believes that the advent of effective DRM technologies should launch a period of lively marketplace experimentation in online delivery by the owners and distributors of copyrighted works and that, as illustrated by the popularity of the Napster service, consumers will make their preferences clearly known. To avoid stifling this lively experimentation, InterTrust believes that, until it is shown to be ineffective in reflecting the balance struck in the Copyright Act, the marketplace should be where consumers, copyright owners, and distributors sort out the ways in which DRM technologies are used to protect and manage rights in copyrighted works.

Why does InterTrust believe this? Because DRM technologies give copyright owners new confidence that their works will be protected in the online environment, DRM technologies also enable them to permit consumers to use copyrighted works in new and more convenient ways, some of which may surpass the scope of copyright exceptions such as the first sale doctrine. For example, while the first sale doctrine exhausts the exclusive right to distribute a copy or a phonorecord of most copyrighted works to the public, it does not limit the other exclusive rights of the copyright owner—reproduction, adaptation, public display, and public performance. With the protection of effective DRM technology, however, some copyright owners and distributors could choose to attract consumers by permitting them to make and display copies.

Moreover, InterTrust’s DRM technology also enables copyright owners and distributors to accommodate a richly diverse range of policies arising through law or through accepted practice (provided they are sufficiently detailed) for use of works by particular groups of consumers, such as schools and universities, libraries and archival institutions, and those with special needs, such as the blind. Consumers are likely to respond favorably to copyright owners and distributors who use these capabilities of DRM technologies to permit flexible use in the course of managing their rights.

QUESTION FROM SENATOR KOHL:

While all of the panelists are primarily concerned with access to the online entertainment marketplace, they must also understand that they have a responsibility to parents. The Internet makes it even more difficult for parents to police the songs that their children hear, the images that they see and the games that they play. I’d like the panelists to discuss what their company or industry plans to do to help parents as online entertainment becomes more readily accessible to all consumers, especially children.

RESPONSE FROM INTERTRUST:

The InterTrust DRM technology includes features that enable entertainment producers and distributors to associate content advisories, such as ratings and labels, with the digital material and to display such advisories when the digital material is opened by consumers. The DRM technology also includes other features that enable parents to control or prohibit access to digital material incorporating such content advisories. Provided that these features are used by producers, distributors, and parents, the content advisories would be persistently associated with the digital material after delivery to the consumer.

Responses of Gerald W. Kearby to questions submitted by Senators Hatch and Leahy

I. INTRODUCTION

Thank you for the opportunity to respond to the written questions from the Chairman and the Ranking Minority Member of the Committee. I have only endeavored to answer the questions that directly pertain to my testimony as supplemented on April 5, 2001 (the Supplement).

Question. Acceptable Protection for Online Content:

Answer. Detailed answers to this question are contained both in my testimony and in the Supplement. To reiterate, the basic points of that testimony, the technology necessary to secure distribute online music has been available for several years. Liquid Audio commercially deployed such a system in 1997, and we are currently developing our 6th generation of products. Liquid Audio requests the opportunity to demonstrate its copy protection system to the Committee. One demonstration is worth several thousand words and, we hope, would set this issue to rest.

Question. When Will Digital Music Come to A Device Near You?

Answer. Unfortunately, it appears as though billions of digital songs are now on a large variety of devices today. I say unfortunately because the vast, vast majority of those digital songs were downloaded from Napster without authorization from the copyright holder. The question should be: when will there be a legitimate market supplying digital music to those devices near you? That is entirely in the hands of the major record labels. As discussed below, it appears that they have taken some first steps towards entering the marketplace. Those steps, however, appear unclear and do not seem to represent an adequate response to the demand in the market.

Question. Record Companies and Online Resellers. Senator Leahy asks: "Do you believe that it is also important for the record companies to make digital music available to those competing retailers capable of offering secure and accountable downloads on a non-discriminatory basis that does not price them out of any competitive opportunity or give them substantially less attractive non-price terms?"

Answer. The answer is simple—yes! To attract the tens of millions of people away from unauthorized distribution of digital music will require adding value to attract them to the legitimate online music sites. Competing resellers of digital music are far better positioned to respond to the market than would be a monolithic captive reseller. Obviously price will be an important factor. But beyond that ease of user, i.e., user interface and additional services such as playlist creation and distribution, music news, personalized music search and delivery, custom CD creation, etc. will need to be created to draw users from illegal services such as Napster.

There are lessons to be learned from the Napster experience beyond the fact that many people will trade music for free. One significant factor is that consumers want all of the music available in one place. A music buyer in the analog world won't tolerate a record store that only carried three of the five major labels' CDs. Unlike buying an automobile, the consumer doesn't go into a record store to buy a brand. They go to buy music by artist, or by song or by genre—few clerks are asked for a Sony Music CD, rather the user would ask, for example, for music by the artist Billy Joel or the song Piano Man. So it is in the digital world. At the moment there are two nascent services: Duet with two labels and Music.Net with three labels. Online resellers must be able to offer one-stop shopping for all the music. Consumers demand it.

Consumers also want an easy to use digital system. They don't want to click through fourteen steps before they can download their music. Competition among resellers will result in the best interfaces succeeding in the market. In addition, to attract customers resellers will have to add value beyond just having all the music. The more legitimate resellers that have access to the music at reasonable non-discriminatory prices, the more services will be developed. That in turn will lure music fans away from unauthorized services.

Responses of Billy Pitts, Executive Vice President, MP3.com Inc., on behalf of Robin Richards, to questions submitted by Senators Hatch and Leahy

Question. For all panelists (especially Mr. Parsons, Mr. Ken Berry, Mr. Murphy, and Mr. Richards, and Mr. Henley and Ms. Morissette): One argument we have

heard in favor of a compulsory license is that music has so many pieces to license and there have been substantial disputes between the record labels, the publishers and technology companies like MP3.com about how to get the publishing rights cleared in the volume demanded by online offerings. Some have suggested that a stumbling block to getting the labels to license sound recordings is that they may not have the rights from their artists to grant these rights. I understand there may even be problems with the MusicNet offering to some degree because of these impediments. Would any of you be interested in commenting on this particular problem and suggest ways to remedy it?

Answer: As we discussed in our written testimony, the existing marketplace and statutory mechanisms for licensing the use of music simply do not work in the digital environment. The My.MP3.com service allows consumers to “store” CDs that they purchase in a digital “locker” and to use any Internet-enabled device to playback the songs on those CDs. There is no practicable way for MP3.com (or similar service providers) to identify and obtain licenses from the copyright owners for each and every song on the wide array of CDs that consumers might choose to store (assuming that it even is necessary to obtain licenses to offer consumers this tool). These practical problems could be overcome by establishing a more streamlined compulsory license, modeled on the satellite and cable licenses (Sections 119 and Section 111). Under such a compulsory license, it would be sufficient for the user of the work to submit to the Copyright Office information identifying the user and the works being used along with semi-annual royalty payments (with rates set by arbitration). The copyright owners whose works were used could then submit claims for their respective shares of the royalty pool.

Question. For all panelists: Mr. Hank Barry argues that we have created compulsory licenses in the past, for publishing rights in music and in rebroadcast of television programming because it was difficult to clear the rights to the myriad creative interests involved in making up a broadcast day. Would anyone like to explain why that analogy does or does not obtain in the online music and entertainment world?

Answer: In the context of cable and satellite retransmissions of broadcast television programming, Congress has recognized that compulsory licensing is necessary to overcome the logistical burdens that would otherwise arise. It is not possible for cable operators and satellite carriers to identify and contact, either in advance or after the fact, each of the copyright owners claiming an interest in each of the dozens of television programs broadcast daily on the broadcast channels that the cable operator and satellite carrier retransmit. The situation presented by the on-line delivery of music, particularly by services that offer access to a vast library of CDs containing hundreds of thousands of song titles, is directly analogous.

Question. For all panelists: I have heard a number of entertainment companies say that acceptable protection for online content simply does not exist yet, that existing Digital Rights Management and watermarks, wrappers, or encryption, is simply not good enough to protect valuable content. Yet we have a number of technology companies here today who believe that they have such a solution, and now we have announcements of online initiatives from all five major labels, which suggests the technological protections have developed recently. Would any of you care to comment on the state of technological protection for content?

Answer: MP3.com’s server-side security system is designed to fulfill the needs of the consumer, the rights-holder, and the emerging technology providers. Our first goal is to provide the consumer with a satisfying experience where he or she may access content already purchased and play that content back to themselves in a secure and transparent environment. Through the development of our Beam-It and Instant Listening programs, we are able to help consumers verify ownership of their CDs and store those CDs in a matter of seconds as opposed to having to wait hours to rip and encode the song themselves and then having to worry about the amount of space the song is taking up on their hard drive. Our security mechanisms have been independently evaluated by Adam Stubblefield and Dan Wallach at the Department of Computer Science at Rice University.

Our second goal is to ensure rights-holders that our system will replicate the protection of their content as well or better than the protection in place in the physical world. Through our server-side DRM system we provide a number of levels of security that are not available in the physical world. For instance, CDs produced today are created without copy protection and CD players are unable to keep users from copying songs at will. Because music can be distributed quickly through the digital space, we have put measures in place to monitor the behavior of an account to make sure that the activity of that account is consistent with the guidelines set by the

content provider. If account sharing or song trading is detected then the account can be disabled.

Finally, we strive to have a system that works independent of any current piece of technology so that it can adapt to new Internet enabled devices (like cell phones and set top boxes) or digital rights management protections without the consumer having to take further action. All security systems are required to evolve over time. Our server-side solution adapts itself to new requirements without incurring hardship on the user by forcing them to go through complex and cumbersome software updates. Further, by managing protection at the server level, rather than the client level, we are able to ensure that the system is ubiquitous.

Question. For all panelists: The premise of this hearing is that digital content is coming soon to digital devices to be enjoyed by consumers soon. Based on our discussion today, how soon is soon, and when will the promise become reality?

Answer: With respect to music, the “promise” that digital content will be available to consumers over a variety of digital devices already is a reality. The technical hurdles to streaming music to a variety of wired and wireless digital devices have largely been overcome. For example, MP3.com has sponsored demonstrations of the use of streaming technology to deliver music to Internet-enabled devices in cars and to phones. The principal obstacle to the full deployment of these and other technological developments is the uncertainty surrounding the status of digital music under the copyright laws and the insistence by copyright owners that streaming of audio over the Internet requires a multitude of separate performance and reproduction/distribution licenses for both the sound recording and the musical compositions embodied in the sound recording.

Question. Mr. Barry, Mr. Richards, Mr. Kearby, and Mr. Farrace: There have been calls for compulsory licensing of sound recordings, of publishing rights, and of “most favored nation” protections for online distributors not affiliated with record companies. Others argue that no one has rights to use property other than the property owner and those the property owner agrees with (with fair use exceptions in the copyright context, of course). Could you each explain what justification you see, if any, for such extreme legislative action, other than that your business plans rely on using the major labels’ content to be successful? Please be specific if you suggest such theories as misuse of copyright, etc.

Answer: MP3.com respectfully disagrees with the suggestion that compulsory licensing and “most favored nation” protections are “extreme” legislative measures. The Section 115 compulsory license for the reproduction and distribution of phonorecords dates back nearly 100 years and was recodified in 1976; in 1995, Congress sought to expressly extend Section 115 to the digital environment (albeit in an imperfect manner that needs to be addressed administratively and/or legislatively as soon as possible). In addition, Congress has enacted compulsory licensing mechanisms for the delivery of broadcast television signals by cable systems and satellite carriers, for the public performance of sound recordings by digital audio transmission, and for certain ephemeral copies. And Congress has recognized a right of non-discriminatory access to vertically-integrated content, both in the Copyright Act (Section 114(h)) and in the Communications Act (Section 628). The underlying bases for these various legislative enactments include overcoming logistical problems in marketplace licensing, ensuring the public’s access to content, and protecting against anti-competitive behavior. Each of these same concerns is applicable to the on-line music environment and justify the establishment of a functional compulsory licensing regime that gives copyright users—and consumers—access to a complete library of sound recordings and musical compositions, while ensuring that copyright owners are fairly compensated. Finally, we note that there is a pressing need for Congress to address and clarify the rights of music consumers with respect to their ability to their use of new technologies. Whether through the application of the concept of “fair use” or through the establishment of clarifying exemptions and/or definitions, the law should distinguish those services that permit music consumers to store and playback the CDs that they purchase and that protect against activities that would allow third parties to access the music without purchasing it (such as file copying and sharing).

Question. Mr. Richards: Could you explain how MP3.com tracks each listen for each song and accounts to the writers and artists whose music is accessed from your service? And do you think you have a model that would be useful for the publishers and recording artist representatives to adopt? Do you think this would afford artists the sort of transparency Mr. Henley and Ms. Morissette seek?

Answer: MP3.com has made significant investments in the development and maintenance of a comprehensive infrastructure system that allows us to report activity on a song-by-song basis. In order to track each “playback” of a particular song, we

create a unique song ID which is affiliated with information relating to that song, including song title, artist name, the associated CD title and the CD's UPC, the identity of the label claiming the master recording right in the recording, the publisher claiming and/or administering the mechanical rights, and all of the payment terms associated with the song. MP3.com aggregates the activity log files at the song ID level on a quarterly basis and reports certain information (such as how many times the song was added to our servers, added to users' accounts, and/or streamed from users' accounts).

MP3.com supports "transparency" in the form of disclosure of information to artists and writers and our tracking system permits us, with the rights-holders' permission, to share key statistics with the public and/or with artists and writers. For example, we currently post songplay and earnings information for those MP3.com artists who participate in our "Payback-for-Playback" program (a program that compensates artists who make songs available on the MP3.com website). We encourage you to visit our site and see the type of information made available. (Example: <http://artiststats.mp3.com/artist—stats/44/ernesto—cortazar.html>).

Question. Mike Farrace, Senior Vice President, at Tower Records testified that some record companies are requiring personal data from and about Towers' customers, prompting concerns by Tower Records about violating its own privacy policy, damaging the relationship with the customer, and "maybe even result[ing] in Tower violating the law."

(A) What sort of personal data are record companies requesting from retail distributors, such as Tower Records, and other online distribution services to provide from or about customers?

(B) Are record companies asking retail distributors to provide any personal data about customers who purchase CDs in brick-and-mortar stores, or have the requests for collection of customer data been limited to online music purchases?

(C) Are retail distributors and online distribution services formulating or revising their privacy policies to accommodate requests from record companies to provide personal data from or about customers?

(D) Are record companies requiring as part of their licensing agreements for digital music that they be provided access to customers' personal data?

Answer: MP3.com is committed to protecting the privacy of its users. A copy of our privacy policy can be found at <http://www.mp3.com/privacy.Yhtml>. While MP3.com receives personal information provided voluntarily by its users in connection with certain activities (e.g., initial sign-up for service, on-line purchases, surveys, contests), we do not sell, rent, or trade personal information with others. Some of our contracts with record labels request that we supply aggregate demographic information (to the extent that we collect such information) to help the labels better tailor their marketing messages. However, we have not been requested to share specific information about users and/or their accounts and we do not share such information.

Question. Concerns have been expressed that "copyright management" measures being developed by copyright owners to control the distribution of their digital works may erode the first sale doctrine. If a customer pays for the personal use of a copyrighted work, the rights holder may use technological means to ensure that the work is not posted on a web site for use by others. Do you believe that the marketplace will sort out the scope of copyright management measures since customers who believe they are not getting what they pay for will simply stop buying?

Answer: MP3.com shares concerns that consumers' rights with respect to their music purchases are being eroded. This concern goes beyond the erosion of the "first sale doctrine"; even the right of a consumer to listen to his or her music purchases is being threatened. Specifically, the "My.MP3.com" service permits purchasers of recorded music to "store" their purchases in digital "lockers" and then to play back their purchases over any Internet-connected device. The owners of the sound recording and musical composition copyrights have argued, and one federal court has agreed, that the storage of recorded music in such lockers and the "personal performances" of the recordings in those lockers, constitutes infringement. It is critical that Congress clarify the rights of consumers to utilize new technologies to store and play back the music that they purchase.

Question. The Copyright Office issued a Notice of Inquiry on March 9, in response to a petition by the RIAA, stating that: "there is considerable uncertainty as to interpretation and application of the copyright laws to certain kinds of digital transmissions of prerecorded musical works. It is also apparent that the impasse presented by these legal questions may impede the ability of copyright owners and users to agree upon royalty rates under section 115. . ." 66 Fed. Reg. 14099, 141101 (2001).

(A) Do you agree with this statement and, if so, please explain how the uncertainty over the legal questions presented in the petition are affecting voluntary licensing agreements for new online music services?

Answer: We strongly agree that the uncertainty surrounding the interpretation and application of the copyright law to streaming audio services in general, and to “personal” digital “locker” services such as My.MP3.com in particular, impedes the ability of copyright owners and users to agree upon royalty rates under Section 115. The music publishers cite the licensing agreement reached between MP3.com and the Harry Fox Agency as evidence that the marketplace is working. In fact, however, that agreement was entered into only after MP3.com was sued by the publishers. This litigation alleged that the “server” and “buffer” copies that are a necessary incident of the operation of the My.MP3.com streaming audio personal digital music locker service infringed the publishers’ reproduction and distribution rights. Although it is unlikely that the publishers could have established that such “copying” had caused them any actual economic harm, the risk of crushing “statutory” damages forced My.MP3.com to enter into licensing agreements despite its disagreement with the publishers’ interpretation of Section 115. The risk of statutory damages, particularly where the underlying legal issues themselves are in dispute, skews the “negotiation” of royalty payments in favor of the copyright owners.

Question. (B) In 1995, the Digital Performance Right in Sound Recordings Act expanded the scope of the mechanical license, under 17 U.S.C. § 115, to include the right to distribute, or authorize the distribution of, by digital transmission both hard copy phonorecords and “digital phonorecord deliveries” or “DPDs.” DPDs are defined in the Act but a subset of DPDs, called “incidental DPDs,” which are also subject to the mechanical licensing process, are not defined. One of the issues before the Copyright Office is to determine what is and what is not an “incidental DPD.” Is this a question that the Copyright Office or the Congress should determine in the first instance?

Answer: MP3.com believes that it may be appropriate for the Copyright Office, in the first instance, to consider what is and what is not an “incidental DPD” and has filed comments to that effect with the Copyright Office. (Copies of MP3.com’s filings with the Copyright Office are attached hereto for your convenience). The outcome of the Copyright Office’s consideration of this issue likely will help define whether, and to what extent, further Congressional action is necessary. However, whatever the outcome of the Office’s consideration of the “incidental DPW” issue, MP3.com believes that Congressional action will be necessary to clarify the rights of consumers to use “personal” digital music locker services to enjoy their purchased music over Internet-enabled listening devices.

Question. (C) The Copyright Office is currently considering the applicability of the section 115 mechanical license to two new services for delivery of digital music: “On-Demand streaming” (which permits users to listen to real-time streamed music they want when they want it) and “Limited Downloads” (which permits users to download music for listening for only a limited time). According to the Notice of Inquiry, these types of services were not “anticipated” when the Congress expanded the scope of section 115 to cover digital transmissions. Is legal uncertainty over the applicability of section 115 to these new services having any effect on the deployment of such services and, if so, please explain what that effect is?

Answer: As noted above, MP3.com, which offers music purchasers “on-demand” streaming by means of a digital music “locker” service, was sued for copyright infringement by the music publishers. As a result of that litigation (and litigation brought by sound recording copyright owners), MP3.com was forced to shut down its service. As detailed in our written testimony submitted to the Committee, MP3.com has not been able to fully relaunch its My.MP3.com service, despite having agreed to pay tens of millions of dollars to various record labels and to the music publishers represented by the Harry Fox Agency. In particular, our ability to provide consumers with access to all of the music in their purchased music lockers is being frustrated both by the uncertainty surrounding the application of Section 115 and the absence of a practicable mechanism for invoking the Section 115 compulsory license.

Question. (D) various music publishers filed suit in December, 2000, against UMG for copyright infringement alleging that UMG was copying sound recordings on servers for its new online music subscription service, Farmclub.com, and stating that: “UMG recently obtained a judgment from this court that the operator of another Internet music service, MP3.com, Inc., had willfully infringed UMG’s sound recording copyrights by placing copies of those sound recordings on its public servers—precisely what UMG has done here without plaintiff’s permission.” Would clarifying the scope of the mechanical license under section 115 of the Copyright Act in

the context of such new online music services help avoid the undue delay and undue distraction from litigation?

Answer: The most important action that can be taken to avoid the undue delay and undue distraction that results from litigation over the use of new on-line tools, such as streaming audio digital music locker services, is for the Copyright Office to clarify its rule (37 CFR Section 255.6) "deferring" the establishment of rates and terms for "incidental DPDs." Such clarification can and should provide a "safe harbor" mechanism whereby copyright users could obtain the protection of the statutory license while the scope of Section 115 is being clarified. Again, however, MP3.com wishes to note that, in the long run, Congress will have to clarify not only Section 115, but also other provisions of the Copyright Act that allegedly are implicated by audio streaming services in general, and by "purchased" digital music locker services in particular.

Question: The record companies have announced new online music services, including MUSICNET and Duet, which will provide competing business-to-business platforms for music subscription services that will cross-license music and offer the services on a non exclusive basis. As Hilary Rosen stated in her testimony, the record companies recognize the need to "ensure that online distribution enhances rather than undermines the commercial viability of our retail partners." "Thus, the non-exclusive nature of these new platforms is important. Do you believe that it is also important for the record companies to make digital music available to those competing retailers capable of offering secure and accountable downloads, on a non-discriminatory basis that does not price them out of any competitive opportunity or give them substantially less attractive non price terms?"

Answer: The issue of non-discriminatory licensing arises not only with respect to "downloads," but also with respect to "on-demand" streaming. Section 114(h) of the Copyright Act should be extended to apply to all "interactive" services.

Responses of Richard D. Parsons to questions submitted by Senator Hatch

Question 1: For all panelists (especially Mr. Parsons, Mr. Ken Berry, Mr. Murphy and Mr. Richards and Mr. Henley and Ms. Morissette): One argument we have heard in favor of a compulsory license is that music has so many pieces to license and there have been substantial disputes between the record labels, the publishers and the technology companies like MP3. com about how to get the publishing rights cleared in the volume demanded by online offerings. Some have suggested that a stumbling block to getting the labels to license sound recordings is that they may not have the rights from the artists to grant these rights. I understand there may even be problems with the MusicNet offering to some degree because of these impediments. Would any of you be interested in commenting on this particular problem and suggest ways to remedy it?

Answer: As this question addresses two different copyrights, the copyright in musical compositions and the copyright in sound recordings, I will need to divide my answer into two parts.

With respect to the copyright in sound recordings, the clearance issues are not complicated and we do not expect that they will present any significant stumbling block to the availability of music for use on subscription and other Internet-based services.

With respect to the copyright in musical compositions, the resolution of issues to allow the administratively convenient and economic licensing of music publishing rights is well under way and does not require Congressional intervention at this time. In particular, these matters should not prevent the timely launch of the MusicNet service in the second half of this year. The clearance issues that have arisen involve interpreting the Copyright Act. We are hopeful that the Copyright Office pursuant to a rulemaking proceeding will resolve them in due course. In this regard, on March 9, the Copyright Office published a Notice of Inquiry and comments were submitted on April 23. Reply comments are due on May 23. The Copyright Office may very well decide that a compulsory license under Section 115 of the Copyright Act already obtains. This would be the case if on-demand streaming ("On-Demand Streaming") is determined to be an incidental digital phonorecord delivery ("iDPD") and time- or use-limited downloads ("Limited Downloads") are determined to be iDPDs or rentals. It is also possible that mechanical compulsory licenses already secured by record companies for the manufacture and distribution of physical records also cover On-Demand Streaming and Limited Downloads. This matter maybe resolved in Mayor June by summary judgment in *The Rodgers and*

Hammerstein Organization, et. al. v. UMG Recordings, Inc., et. al., a case pending before the United States District Court, Southern District of New York. Thus, the issues relating to On-Demand Streaming and Limited Downloads, which are the services to be provided by MusicNet, are well on their way to being resolved and any Congressional intervention would be premature.

Question 2: For all panelists: Mr. Hank Barry argues that we have created compulsory licenses in the past, for publishing rights in music and in rebroadcast of television programming because it was difficult to clear the rights to the myriad creative interests involved in making up a broadcast day. Would anyone like to explain why that analogy does or does not obtain in the online music and entertainment world?

Answer: Once again, I must make a distinction between musical compositions and sound recordings.

We would have no problem with a mechanical compulsory license for use of musical compositions in On-Demand Streaming and Limited Downloads. As I pointed out in my answer to Question 1 above, it may already exist under Section 115 of the Copyright Act. The mechanical compulsory license for musical compositions is a bedrock concept in the U.S. music publishing business; indeed music publishers have favored retaining it in the law. In fact, a mechanical compulsory license first appears in the Copyright Act as enacted in 1909.

On the other hand, in the U.S. record business a compulsory license for sound recordings has been the rare exception, not the norm, and is completely inappropriate in this instance. There is no need for so drastic a remedy. First, the marketplace is already working. In the last 18 months, Warner Music Group (“WMG”) has entered into content agreements with a subscription service, three digital locker services, seven streaming video services and five Internet radio services. Second, particularly in the Internet space, a sound recording copyright owner must have leave to determine how and when his, her or its works are used. A sound recording, unlike a musical composition which is not enjoyed by itself except in printed form, is a consumer product. The potential for cannibalization of physical sales and permanent downloads by subscription business models is high. Security is also a significant matter. Substitutability and copy protection issues endemic to the Internet pose great risks for record companies. Accordingly, sound recording copyright owners must have the ability to structure their relationships with Internet-based music services in order to take these essential concerns into account. Third, the worldwide nature of the Internet makes a U.S. compulsory license impractical at best. Fourth, commercial models are still evolving. Last year, permanent downloads were thought to be the future of the music business. This year they look less promising and the subscription model is in vogue. The “one size fits all” approach implicit in a compulsory license regime is manifestly unsuitable for a nascent and rapidly evolving marketplace.

Question 3: For all panelists: I have heard a number of entertainment companies say acceptable protection for online content simply does not exist yet, that existing Digital Rights Management and watermarks, wrappers, or encryption, is simply not good enough to protect valuable content. Yet we have a number of technology companies here today who believe that they have struck a solution, and now we have announcements of online initiatives from all five major labels, which suggests the technological protections have developed recently. Would any of you care to comment on that state of technological protection for content?

Answer: Progress has been made in the development of copy-protection technologies and we have been working with technology providers for both online music and film content. We no longer see the lack of reliable copy protection technologies as a gating factor to the launch of Internet-based content businesses. That being said, protecting content on the Internet poses several challenges. Among these are the very structure of the Internet as a completely decentralized network with no single “command center” or server and the fact that the computer environment is designed to facilitate, not thwart, the reproduction and dissemination of data files.

It is clear that no single technology will provide a complete solution. Rather, it is necessary to employ a combination of encryption and watermarking tools, coupled with enforceable rules regarding copying and secondary transmissions. In addition, hardware and computer companies must ultimately build support for protection technologies into their products in order for these systems to be viable. While no content protection technology will be “bullet proof” and battling hackers will be an ongoing reality, we are working with our technology suppliers to ensure that systems will be upgradeable and renewable so as to quickly address and frustrate such attacks.

Question 4: For all panelists: The premise of this hearing is that digital content is coming soon to digital devices to be enjoyed by consumers soon. Based on our discussion today, how soon is soon, and when will the promise become reality?

Answer: As mentioned in my answer to Question 2, WMG has already provided its content to many Internet-based music services, among them the MusicNet service. MusicNet is still on schedule for a public launch in the late summer/early fall of this year. In fact my company has long been a leader in the introduction of new digital devices. Although I may be accused of being too literal, I should point out that WMG has been releasing digital devices (i.e., CDs) since 1983. In March of 1997, Warner Home Video was the first to release motion pictures in the U.S. in DVD form, a digital device vastly superior to consumer videocassette. In fall of 2000, WMG was the first to release sound recordings in the U.S. in DVD Audio form, an exciting new digital device that improves on the CD by providing higher fidelity and six-channel surround sound.

Question 5: For all panelists: Is there any point you feel should be raised or that you would like to further respond to the completeness of our record?

Answer: No.

Question 6: Mr. Parsons, Mr. Ken Berry and Ms. Rosen: Do record companies have problems granting blanket licenses to third parties for digital distribution of an artist's recordings or settling lawsuits because of agreements with artists, such as "coupling" restrictions in their recording agreements (coupling is compiling an artist's recording(s) together with master recordings by other artists) such that the record companies would need the artist's approval to do so? Does a record company have the rights to distribute an artist's recording absent the accompanying artwork without an artist's approval under most recording agreements? If they don't, how can they do so via digital distribution?

Answer: Because we sometimes have agreements with third parties that restrict our rights, WMG cannot grant rights for digital distribution with respect to every single sound recording that it owns and/or controls without exception. Nonetheless, WMG can (and does) grant rights with respect to every single sound recording that it owns and/or controls subject only to third-party restrictions. Typical recording agreement provisions that restrict "coupling" or artwork use would not prohibit the use of sound recordings or their associated artwork in current digital distribution models. It would be rare for a recording agreement to prevent a record company from settling lawsuits with copyright infringers.

Question 7: Mr. Parsons, Mr. Ken Berry, and Ms. Rosen: Has there been any discussion or consideration about the basis on which record companies will share with artist monies they receive from blanket licensing, damage awards, or equity/stock participations they receive from third party companies?

Answer: Every recording agreement is different, so there can be no fixed basis upon which record companies compensate artists. WMG will, of course, abide by the terms and conditions of its recording agreements. In particular, as we have previously announced, WMG will share with artists the monies received by WMG in connection with its MP3.com settlement agreement in accordance with the terms of the applicable artist agreements.

Question 8: Mr. Parsons and Mr. Ken Berry: At the April 3, 2001, Senate Judiciary Committee hearing on online entertainment, Napster's CEO Hank Barry discussed the licensing complexities related to music webcasts and limited downloads. According to Mr. Barry, the MusicNet music licensing deal, which is a joint venture between AOL Time Warner, EMI, BMG, and RealNetworks, may not allow companies to offer the type of online music services consumers desire if the planned MusicNet licenses do not include publishing rights. Mr. Barry queried whether MusicNet license would include these publishing rights. In response to Mr. Barry's comments, Senator Feinstein asked Mr. Parsons to respond. Mr. Parsons responded that, "the full complement of rights to enable the streaming or downloading of our catalogues—EMI's, Warner Music, BMG's—is included in the license that we gave the MusicNet. "Can you clarify for us whether the MusicNet licenses you have granted include all of the required publishing rights, and the distinguish for us whether you mean that you are granting all publishing rights your entities-control, or all rights your entities control related to sound recordings your companies control, and whether you have cleared publishing licenses from outside publishers of music on sound recordings you control or whether the new MusicNet entity will have to clear these rights of third party publishers?"

Answer: In essence, WMG's Subscription Services Agreement with MusicNet includes all of the required publishing rights. The agreement requires WMG to obtain mechanical licenses for musical compositions embodied in sound recordings owned and/or controlled by WMG to the extent that such mechanical licenses can be ob-

tained by compulsory means under Section 115 of the Copyright Act. Accordingly, WMG has proceeded with the first wave of a large compulsory licensing program pursuant to which, at the end of April, WMG sent Notices of Intention to approximately 3,000 music publishers in order to obtain approximately 17,000 licenses for musical compositions embodied on approximately 13,000 sound recordings owned and/or controlled by WMG. Our current plan is for this licensing effort to continue. The Subscription Services Agreement does not grant MusicNet mechanical licenses for musical compositions controlled by Warner/Chappell Music, Inc. These licenses will also be obtained pursuant to WMG's compulsory licensing program. The Subscription Services Agreement requires MusicNet to obtain performance licenses for musical compositions embodied in sound recordings owned and/or controlled by WMG. These rights are easily secured on a blanket basis in the U.S. from ASCAP, BMI and SESAC.

Question 9: Mr. Parsons and Mr. Ken Berry: This week has seen a handful of announcements in the digital media space. While I have seen this a step forward, I have heard some skepticism concerning these deals given the timing of the announcements in the relation to the committee's hearing and the relative lack of specificity. Accordingly, please answer the following questions with respect to the recently announced MusicNet deal.

Question a: Does the deal allow for the immediate licensing for subscription download of EMI, Warner Music, and BMG's entire music catalogs?

Answer: Yes, but not entire (see Question 6 above). WMG will be able to make available a substantial portion of its repertoire to MusicNet.

Question b: At what specific date will the full MusicNet download service be made available to the entire public, rather than on a beta, regional, or ISP membership basis?

Answer: See Question 4 above. The beta version will be ready as early as May.

Question c: Will the MusicNet license include all necessary publishing rights and, if not, on what date will all publishing rights be available?

Answer: See Question 8 above.

Question d: Will MusicNet be technology neutral, or will it require licensees to implement a particular proprietary technology?

Answer: There is nothing in the MusicNet transactional documents that ties MusicNet to a particular DRM or CODEC. Technology decisions will be made by MusicNet's management in the best interests of MusicNet and will be overseen by MusicNet's board. MusicNet at present has a 7-member board (2 independent directors, 2 appointed by RealNetworks and 1 appointed by each of EMI, BMG and WMG). Where there are interested directors, board decisions will be determined by a majority of the disinterested directors. In addition, WMG's Subscription Services Agreement with MusicNet permits MusicNet to make WMG's content available using any of along list of DRMs or CODECs.

Question e: Will other ISPs enjoy the same licensing terms (including prices, catalog available, etc) as AOL and other ISPs with equity stakes in MusicNet enjoy, yes or no?

Answer: Nothing in the MusicNet transaction would limit another ISP's ability to enjoy the same licensing terms as AOL. As described below, MusicNet will negotiate all content and distribution relationships on an arm's-length basis.

MusicNet's deals with content companies (including EMI, BMG and WMG) will be negotiated by the CEO of MusicNet or another officer of MusicNet designated by the CEO (the "Licensing Negotiator"). The Licensing Negotiator in the performance of his/her duties will report only to MusicNet's independent directors and the directors appointed to MusicNet's board by RealNetworks. The terms of content licenses are to be maintained in strict confidence by the Licensing Negotiator, MusicNet and its officers and employees, the independent directors and the RealNetworks directors. They may not be divulged to any third party (including EMI, BMG and WMG).

MusicNet's deals with distribution companies (including AOL and RealNetworks) will be negotiated by the CEO of MusicNet or another officer of MusicNet designated by the CEO (the "Distribution Negotiator"). The Distribution Negotiator in the performance of his/her duties will report only to MusicNet's independent directors and the directors appointed to MusicNet's board by any stockholder that is not a party to and does not have an affiliate that is party to a distribution agreement. The terms of distribution agreements are to be maintained in strict confidence by the Distribution Negotiator, MusicNet and its officers and employees, the independent directors and the directors appointed to MusicNet's board by any stockholder that is not a party to and does not have an affiliate that is party to a distribution

agreement. They may not be divulged to any third party (including AOL and RealNetworks).

Question 10: Your testimony made clear that you do not believe compulsory music licensing for interactive services to be necessary or desirable, citing MusicNet and other recent licensing initiatives by major record labels as evidence that product is beginning to flow to the market. What is your reaction to the suggestion of a sort of “Most Favored Nation” statute, similar to the program access rules for subscription television licensing, that required large copyright holder entities that engage in cross-licensing of their catalogs to make the licensed materials available on essentially the same terms and conditions to, for example, similar internet-based music distribution or “locker” services?

Answer: We do not believe that a regulatory mandate similar to the program access rules for subscription television licensing is either necessary or advisable for licensing music to interactive services. Television delivery services are much more uniform in their function of delivering programming to a consumer. The consumer experience of receiving a particular program from a cable operator versus a satellite operator, for example, is basically the same. In contrast, interactive digital music delivery services vary greatly. Some services just stream music for consumer listening. Others involve a storage or locker service for music that a consumer already owns. Still others offer consumers the ability to download music and keep a permanent copy. Furthermore, these services vary in the level of security that they offer to content suppliers. Given the variety of business models and the speed at which such models are changing and evolving, it would be impracticable and unwieldy to apply a “Most Favored Nation”—type approach. Moreover, applying a “Most Favored Nation” concept to this arena would likely have the perverse consequence of discouraging music owners from licensing to start-up services, promotional services, or niche-market-oriented services, with the result of a smaller array of choices for consumers.

Question 11: Mr. Parsons and Mr. Ken Berry (and perhaps Ms. Rosen): can any of you explain what relevance traditional artist royalty reductions like those for packaging, returns or free goods have in cyberspace, and why those are not savings available in cyberspace that can be shared by consumers and artists as well as labels? What assurance can you give Mr. Henley and Ms. Morissette that the royalties earned on interactive services granted in the Digital Performance Rights Act will be passed on to them in a fair and equitable way rather than recouped against recording costs or otherwise kept by the labels? If you believe they should be recouped, please explain why?

Answer: Some traditional royalty reductions found in recording agreements will be relevant to the Internet space, although it is hard to predict at this time which ones they will be. I don’t believe that returns will be a relevant concept in the Internet space. Free goods may be relevant, if, for example, we are actually giving away permanent downloads to incentivize online retailers or to obtain positioning. Packaging deductions may be relevant to the extent that, as in the physical world, they are employed to arrive at a royalty-per-unit that will be acceptable to both the artist and the record company.

There appears to be a widespread public belief that a record company’s profit margins in the Internet world will be higher than in the physical world. It is far too early to know this with any certainty. While we certainly hope the public is right, there are a number of facts at our disposal which challenge that assumption. First, a download is a less-fully-realized consumer product than a CD as the CD includes artwork and the physical medium that makes the product portable. Therefore, it is highly likely that the price a consumer is prepared to pay for a download will be less than the price he or she is prepared to pay for its physical analog. Second, while there are no printing, manufacturing or physical distribution costs associated with a download, the distribution of downloads will implicate a whole new series of expenses including hosting costs, bandwidth delivery costs, content preparation costs and license fees attributable to security and digital rights management technologies. These expenses are roughly equivalent to any savings achieved by not having to print, manufacture and distribute a physical record. Perhaps, over time, the volume of digital transactions may drive efficiencies that lower costs and increase record company margins.

In general, our recording agreements, as negotiated, provide that royalties otherwise payable to artists are applied in recoupment of certain payments made to or on behalf of artists such as recording costs, some video production costs, tour support and some independent promotion costs. This course of dealing, developed over many years, reflects the marketplace realities and the large investments that a record company makes in an artist’s career. In this regard, our recording agree-

ments don't make a distinction between royalties accruing from physical and non-physical distribution models.

Responses of Richard D. Parsons to questions submitted by Senator Leahy

Question 1: Mike Farrace, Senior Vice President, at Tower Records testified that some record companies are requiring personal data from and about Tower's customers, prompting concerns by Tower Records about violation its own privacy policy, damaging the relationship with the customer, and "maybe even result[ing] in Tower violating the law."

Question a: What sort of personal data are record companies requesting from retail distributors, such as Tower Record, and other online distribution services to provide from or about customers?

Answer: In general, WMG does not request personal data from retail distributors and online distribution services with respect to their customers. In fact, as a practice, we do not request and have not received such data from any retail distributor or online distribution service. (For the purposes of this question, I am assuming that you mean "online distribution services" to be the Internet analog to "brick-and-mortar.")

Question b: Are record companies asking retail distributors to provide any personal data about customers who purchase CDs in brick-and-mortar stores, or have the requests for collection of customer data been limited to online music purchases?

Answer: There is only one situation where WMG asks "brick-and-mortar" stores to provide personal data about customers who purchase CDs. Certain chains such as Newbury Comics and CD World have "frequent shopper card" programs that provide discounts to high-volume customers. In applying for such cards, the customers provide certain personal data to the stores and agree to let the stores share some of that data with record companies. WMG gets limited demographic data from these stores with respect to such customers' purchases (e.g., age and gender), but not the names of the customers.

Question c: Are retail distributors and online distribution services formulating or revising their privacy policies to accommodate requests from record companies to provide personal data from or about customers?

Answer: I don't know. This question would best be addressed to Mr. Farrace.

Question d: Are record companies requiring as part of their licensing agreements for digital music that they be provided access to customers' personal data?

Answer: In some of WMG's agreements with digital music services, WMG may be provided with limited access to customers' personal data provided that such data is legally obtained by the relevant service and is in accord with such service's "privacy policy." For example, in WMG's digital download fulfillment agreements with companies such as Liquid Audio and RioPort, WMG may be provided with the names, e-mail addresses and zip codes of purchasers of WMG content, provided, that the customer has explicitly consented to have such information made available to WMG via an "opt-in" process that informs such customer of how such information will be used. In WMG's typical music locker service agreements such as with MP3.com and Echo, WMG may be granted the ability to solicit customers to purchase WMG products and may also be granted access by such services to general information pertaining to individual customers. In most, if not all, of WMG's agreements with digital music services, WMG is provided with aggregated customer demographic data on a no-name basis and only so long as providing such information does not run awry of the applicable service's "privacy policy." Finally, when WMG runs contests, e-mail blasts and other promotions through Internet music services such as ARTISTdirect or MP3.com, consumers may be given the option to learn more about a particular WMG artist or another WMG artist by providing certain personal data (e.g., an e-mail address) and clicking "ok."

Question 2: Jack Valenti testified that within four to six months, several movie studios plan to use the Internet to transmit movies to American homes in encrypted form, but that more protection may be needed, "some of which might require congressional legislation. "In the Digital Millennium Copyright Act (DMCA), the Congress has provided protection for technological measures that effectively control access to copyrighted works and barred the manufacture, import or sale of products or services primarily designed to circumvent such technological measures. 17 U.S.C. § 1201 (a)(1) & (2). Please describe the circumstances where additional protection

may be warranted and the areas not already covered by the DMCA where additional legislation may be requested.

Answer: The DMCA, along with the balance of U.S. copyright law, currently functions well in the Internet environment. The recent court decisions in the DeCSS and the Napster cases recognize the importance of granting legal protections to copyrighted works and technical protection measures on the Internet. We do not believe additional legislation is needed at this time. Nevertheless, as the technical and business digital landscape evolves, the law may need to change with it. In particular, as we move to delivering more of our content online, including films, legislation may be needed at some point in the future to supplement the cross-industry efforts among the content, consumer electronics, computer and online service provider industries to ensure adequate security to support these new business models and delivery channels.

Question 3: Concerns have been expressed that “copyright management” measures being developed by copyright owners to control the distribution of their digital works may erode the first sale doctrine. If a customer pays for the personal use of a copyrighted work the rights holder may use technological means to ensure that the work is not posted on a web site for use by others. Do you believe that the marketplace will sort out the scope of copyright management measure since customers who believe they are not getting what they pay for will simply stop buying?

Answer: Much confusion has surrounded the issue of the first sale doctrine and its application to the online world. The first sale doctrine distinguishes possessory personal property rights from copyrights. Under the first sale doctrine, the owner of a tangible copy of a work may transfer possession of (e.g., sell, lend or give away) that particular copy to another person. Two persons cannot have simultaneous possession of the particular copy and the first sale doctrine does not permit additional copies of the work to be made. Thus, if someone buys a CD and then gives it to a friend, the first sale doctrine applies to that activity. However, if the purchaser buys the CD and then rips it into an MP3 file and e-mails that file to a friend, the first sale doctrine has been exceeded. This is because the purchaser has made a copy of the work, rather than simply transferring possession of an existing copy.

The question poses an example of a consumer who pays for the personal use of a copyrighted work and the possibility that the owner of the copyright in the work might apply technical measures to prevent the consumer from posting the copy of the work to a website for use by others. In this example, the posting of the copy by the consumer would, even in the absence of technical measures, not be permitted under the first sale doctrine. Such a posting would involve unauthorized reproduction of the work and unauthorized distribution of the additional copies, enabling the consumer to retain his or her copy while simultaneously giving copies away to many others. Hence the application of copyright management measures to prevent or discourage this type of activity in no way erodes or undercuts the first sale doctrine.

We believe that the application of “copyright management” measures will actually facilitate a wide array of content offerings to consumers at varying price points. And we agree that the marketplace will sort out the scope of such measures based on what consumers find acceptable. If consumers find that they are getting value for what they pay for, then, they will accept technical measures. Indeed, the experience of DVD—with its technical protections for motion picture content—bears out this principle; consumers have embraced DVD faster and more enthusiastically than any other format, including CD and VHS, both of which were unprotected.

Question 4: Retailers of music, movies, video games and other copyrighted works have expressed concern about whether copyright management measures and end user licensing agreements will erode the ability of retailers and distributors to distinguish themselves from one another in meaningful ways with the potential of stifling competition among retailers, since those measures may set uniform prices, policies and terms for online distribution of digital works.

Question a: Please explain whether you believe that uniform copyright management measures and user licensing agreements carry the potential risks for competition identified by retailers?

Answer: Copyright management measures, in terms of technical protection measures, should have no detrimental impact on legitimate retailers and distributors and their ability to compete. Measures employed to prevent unauthorized access or unauthorized reproduction or distribution operate so as to be transparent to all legitimate uses by a consumer. Thus, for example, the high-quality viewing experience that the consumer gets with DVD is in no way impaired by the fact that the motion picture content on DVD is encrypted. The application of this technical protection to DVD has had no negative impact on retailers’ and distributors’ abilities to compete and distinguish themselves in pricing and promotion.

It is not entirely clear what that term “end user licensing agreements” is intended to mean—whether (i) licensing agreements directly between record companies and consumers or (ii) the terms that record companies may require retailers to abide by in selling product to end consumers. In either case, such agreements would pose no threat to competition.

As for the first scenario, consumers will naturally continue to buy records where it is convenient to do so. That means they will continue to go to retailers that provide a full range of music (and can offer service and an attractive price), rather than record companies that only have a limited selection. Moreover, record companies have an interest in the promoting and selling their product broadly, so they have an on-going interest in maintaining a healthy network of retailers. Thus, retailers should continue play a central role in making digital music available to consumers (just as they have in sales of CDs whether in traditional stores or through websites), and direct purchases from record companies are likely to remain a relatively small portion of transactions.

As for the second scenario, retailers may need to abide by certain restrictions to protect copyrights (for example, if the record company and music publishers have been able to grant rights to a retailer only for a particular country—such as the United States—then the retailer would need to take steps to assure that it does not make the recording available outside of that territory). But just as such competition has flourished among “brick-and-mortar” retailers while respecting such copyright restrictions, it should do so among online retailers as well.

Question b: Would variation in the terms for pricing, use policies and terms for the distribution of digital works provide flexibility for different distribution models and give the consumer the maximum number of choices?

Answer: Certainly. Record companies have an interest in exploring a number of different models for making digital music available to consumers—in terms of price, format (stream versus download), and packaging. Ultimately, the range of choice will be determined by consumer preferences, the extent of retailer ingenuity, and practicality.

Question 5: The Copyright Office issued a Notice of Inquiry on March 9, in response to a petition by the RIAA, stating that: “there is considerable uncertainty as to interpretation and application of the copyright laws to certain kinds of digital transmissions of prerecorded musical works. It is also apparent that the impasse presented by these legal questions may impede the ability of copyright owners and users to agree upon royalty rates under section 115. . . .” 66 Fed. Reg. 14099, 141101 (2001).

Question a: Do you agree with this statement and, if so please explain how the uncertainty over the legal questions presented in the petition are affecting voluntary licensing agreements for new online music services?

Answer: Yes, I do agree with the statement. In order to give you some idea as to the significance of the problem, I will focus on On-Demand Streaming alone and set aside Limited Downloads, which may be even more complicated.

At present, a service that provides On-Demand Streaming to consumers doesn’t know whether it needs to obtain mechanical licenses in musical compositions embodied on sound recordings. If the service fails to obtain mechanical licenses (even though there is uncertainty as to whether it is required to do so), it risks being pursued as a copyright infringer. If the service wishes to cover itself by obtaining mechanical licenses (even though such licenses may be unnecessary), it is unclear whether those mechanical licenses must be negotiated directly with a myriad of publishers or whether the licenses can be secured under Section 115 of the Copyright Act. Either process—direct negotiation or invoking Section 115—is extremely burdensome from an administrative point of view. In the case of direct negotiation, the service may end up inadvertently committing to an uncommercially high rate. By invoking Section 115, the service may obtain mechanical licenses but runs the risk that the rate, as later determined, will be uneconomic.

Question b: In 1995, the Digital Performance Right in Sound Recordings Act expanded the scope of the mechanical license, under 17 U.S.C. Section 115, to include the right to distribute, or authorize the distribution of, by digital transmission both hard copy phonorecords and “digital phonorecords deliveries” or “DPDs.” “DPDs are defined in the Act but a subset of DPDs, called incidental DPDs, “which are also subject to the mechanical licensing process, are not defined. One of the issues before the Copyright Office is to determine what is and what is not an “incidental DPD. “Is this a question that the Copyright Office or the Congress should determine in the first instance?

Answer: This is clearly a question for the Copyright Office. First, the question falls squarely within the Copyright Office’s authority and proficiency. As long recog-

nized by Congress and the courts, it is the job of the Copyright Office to interpret the Copyright Act and function as an expert advisor on issues of copyright law. Second, time is pressing and the Copyright Office rulemaking process that is already underway will resolve this question more far more quickly than Congress or the courts.

Question c: The Copyright Office is currently considering the applicability of the section 115 mechanical license to two new services for delivery of digital music: “On-Demand Streaming” (which permits users to listen to real-time streamed music they want when they want it) and “Limited Downloads” (which permits users to download music for listening for only a limited time.) According to the Notice of Inquiry, these types of services were not “anticipated” when the Congress expanded the scope of section 115 to cover digital transmissions. Is legal uncertainty over the applicability of section 115 to these new services having any effect on the deployment of such services and, if so please explain what that effect is?

Answer: Given the ambiguities surrounding the mechanical licensing of musical compositions, the administrative burdens and economic risks in launching an Internet-based music service are extremely high. These ambiguities will dissuade all but the most highly-motivated companies from attempting to develop or invest in the development of such a service. Even those that choose to proceed will be hampered considerably by the enormity of the rights clearance process. This marketplace cannot thrive unless the Copyright Office resolves the uncertainties.

Question d: Various music publishers filed suit in December, 2000, against UMG for copyright infringement alleging that UMG was copying sound recordings on servers for its new online music subscription service, Farmclub.com, and stating that “UMG recently obtained a judgment from this court that the operator of another Internet music service, MP3.com, Inc., had willfully infringed UMG’s sound recording copyrights by placing copies of those sound recordings on its public servers—precisely what UMG has done here without plaintiffs permission.” Would clarifying the scope of the mechanical license under section 115 of the Copyright Act in the context of such new online music services help avoid the undue delay and undue distraction from litigation?

Answer: The effect of the Copyright Office’s commencing a rulemaking proceeding regarding the application of the mechanical compulsory license of Section 115 to certain digital music services will be to reduce the potential for future litigation, streamline the rights clearance process and accelerate the proliferation of digital music services.

Question 6: Hillary Rosen has testified that RIAA member companies have committed to licensing Napster once the service operates in a fashion that respects copyrights and Napster has an agreement with Bertelsmann to help develop this system. What is the current status of Napster’s efforts to develop a technological upgrade to digital rights management system that is secure and addresses the needs of artists and copyright owners addresses the rights of artists and copyright owners? Has Napster been able to share a new technological approach with (a) the court; (b) with artists or (c) with copyright owners? When does Napster expect to be able to introduce the new technological model?

Answer: We don’t know the current status regarding Napster’s efforts to develop a secure system, we are not aware whether Napster has shared any new technology approach with the courts or artists and we don’t know when or if Napster will be introducing a new technological model. Napster would best answer those questions. In February and March of this year, Napster executives communicated on several occasions with WMG executives concerning Napster’s intention to implement an acoustic fingerprinting technology intended to “screen out” unauthorized sound recordings.

Question 7: The recording companies have announced new online music services, including MusicNet and Duet, which will provide competing business-to-business platforms for music subscription services that will cross-license music and offer the services on a nonexclusive basis. As Hilary Rosen stated in her testimony, the record companies recognize the need to “ensure that online distribution enhances rather than undermines the commercial viability of our retail partners.” Thus, the non-exclusive nature of these new platforms is important. Do you believe that it is also important for the record companies to make digital music available to those competing retailers capable of offering secure and accountable downloads, on a non-discriminatory basis that does not price them out of any competitive opportunity or give them substantially less attractive non price terms?

Answer: As stated above, the MusicNet service will be offered on a non-exclusive basis to various distributors including portals and music portals and certainly to online retail sites. WMG’s Subscription Services Agreement with MusicNet is non-ex-

clusive and WMG would be able to provide its content directly to any such distributor that itself wishes to build a subscription infrastructure. It is certainly important for WMG to make its content widely available to those companies that are in a position to provide opportunities for the promotion or sale of such content. The price or non-price terms relating thereto will be negotiated on an arm's-length basis in accordance with all applicable laws.

Responses of Hilary Rosen to questions submitted by Senator Hatch

Question 1: One argument we have heard in favor of a compulsory license is that music has so many pieces to license and there have been substantial disputes between the record labels, the publishers and technology companies like MP3.com about how to get the publishing rights cleared in the volume demanded by online offerings. Some have suggested that a stumbling block to getting the labels to license sound recordings is that they may not have the rights from their artists to grant these rights. I understand there may even be problems with the MusicNet offering to some degree because of these impediments. Would any of you be interested in commenting on this particular problem and suggest ways to remedy it?

Answer: It is true that licensing in the music business is complicated. This is especially true with respect to musical compositions, because music publishers and songwriters have chosen to bifurcate the licensing of their rights, with performing rights organizations like ASCAP, BMI and SESAC licensing performance rights and The Harry Fox Agency licensing reproduction and distribution. There is of course, already a compulsory license for the reproduction and distribution of musical works. However, the Copyright Office regulations implementing that license prescribe procedures that are not well suited to Internet licensing. We have asked the Copyright Office to simplify these procedures to facilitate the launch of subscription digital music services, and we believe the Office has the ability to make significant improvements in these procedures within the existing statutory framework.

With respect to sound recordings, the recording industry is moving rapidly to adapt to licensing at Internet speed. If any artist contracts limit the ability of labels to make some recordings available electronically those issues will be worked out between the individual label and artists. To date, such limits have not prevented record companies from making the vast majority of the songs in their catalogs available for licensing. If artists choose not to work with labels to make their songs available for electronic distribution, I respect their decision, however it is clear that if consumers are not offered legitimate versions, they will find pirate versions of the music they want.

It is easy to launch an infringing service that makes no effort to see that creators and copyright owners are compensated, and may even be consciously ignorant of the recordings being distributed. Launching a legitimate service requires more effort and infrastructure. Right now, record labels are moving as quickly as they can to open new outlets for recordings by launching new services, partnering with distributors and licensing their catalogs for various kinds of Internet use. As part of this effort, they are creating the infrastructure necessary to support legitimate Internet music services, including libraries of encoded recordings, databases of rights information, and royalty distribution systems, as well as determining whether there are limits on the electronic distribution of certain of their recordings. This effort cannot be completed overnight, but once it has been done for one Internet licensing deal, every subsequent deal, and the launch of every subsequent service, will be easier and faster.

Question 2: Mr. Hank Barry argues that we have created compulsory licenses in the past for publishing rights in music and in rebroadcast of television programming because it was difficult to clear the rights to the myriad creative interests involved in making up a broadcast day. Would anyone like to explain why that analogy does or does not pertain in the online music and entertainment world?

Answer: The compulsory licenses identified in the question arose from situations nothing like we have today in the case of Internet music services. The other compulsory licenses—for cable and satellite retransmission and mechanical reproduction—arose not because it was difficult to obtain copyright “clearance,” but because copyright owners were granted new rights covering existing but peripheral uses of their works, and there was a real concern that copyright owners would not make their copyrighted works available to existing users.

The mechanical compulsory license came about at a time when the core business of music publishers was selling sheet music, after the Supreme Court held that

copyright owners had no right to exclude piano roll makers from manufacturing copies of their works in the form of piano rolls. Congress reversed that decision, but having heard that music publishers might grant exclusive rights to one piano roll manufacturer, Congress decided to limit the right to mechanical reproduction with a compulsory license so that musical works would continue to be available to all potential users. Thus, music publishers never had an exclusive right to mechanically reproduce their works and instead have developed their business around the compulsory license. Indeed, publishers have so embraced the compulsory license that they insisted that the compulsory license be retained and extended to electronic music delivery in 1995.

Similarly, the cable compulsory license came about at a time when cable television was not nearly so commercially significant as broadcast television, after the Supreme Court held that copyright owners had no right to stop cable retransmission of broadcast signals. In granting copyright owners rights with respect to cable retransmissions, Congress limited those rights with a compulsory license, so that cable systems would not need permission to continue to make broadcast signals available to their subscribers. Once a cable compulsory license was in place, and satellite systems were denied the right to be considered “cable systems,” the satellite compulsory license naturally followed.

By contrast, reproduction and distribution of sound recordings are the core rights and core business of record companies. Unlike these other compulsory licenses, a compulsory license to reproduce and distribute sound recordings would take away the most important existing rights record companies have in their sound recordings and threaten the core business of record companies—distributing copies of their recordings in whatever media consumers then demand. There is no problem with the availability of sound recordings that would warrant this unprecedented action. Record companies are licensing their sound recordings for use on the Internet regularly and have signed dozens of deals already. Recently, record companies have formed two competing joint ventures, MusicNet and Duet, that intend to amass catalogs of recordings as large as they can and make them available on a nonexclusive basis for Internet distribution. In short, there is no question that sound recordings are being made available.

Furthermore, a compulsory license might not be economically significant so long as electronic distribution accounts for a miniscule percentage of record sales. However, if electronic music delivery becomes as commercially significant as we all hope it will, a compulsory license could dramatically affect the economics of the industry and the bargains between artists and record labels. Record companies make business decisions, and strike agreements with artists, based on the income record labels can expect to receive from selling recordings under exclusive rights of reproduction and distribution. If there were a compulsory license for electronic distribution, as electronic distribution became more important, the royalty provisions of the compulsory license increasingly would determine the economics of the record business. The government should not force any industry to have its profitability determined every five years by three arbitrators. Doing so would be unfair, a dramatic departure from the precedents cited by Mr. Barry, and quite possibly a violation of the Constitution or U. S. treaty obligations.

Finally, the American recording industry is the most vibrant national recording industry in the world. A compulsory license on sound recordings would give away our cultural heritage and one of America’s best trade assets.

Question 3: I have heard a number of entertainment companies say that acceptable protection for online content simply does not exist yet, that existing Digital Rights Management and watermarks, wrappers, or encryption, is simply not good enough to protect valuable content. Yet we have a number of technology companies here today who believe that they have such a solution, and now we have announcements of online initiatives from all five major labels, which suggests the technological protections have developed recently. Would any of you care to comment on the state of technological protection for content?

Answer: The technology for protecting copyrighted works is developing nicely. One interesting development in the last year or two has been that the software and technology companies—responding to the demands of the marketplace—have started to focus on developing methods of promoting legitimate commerce by protecting rights, rather than methods of recklessly disseminating other people’s content without their consent. RIAA is encouraged by this newfound enthusiasm for rights management and protection technologies.

Record labels, among other copyright owners, have formed partnerships with technology companies to create and implement creative and flexible methods for enabling the electronic distribution of copyrighted works in ways that are easy for consumers to use, while providing appropriate protection to copyright owners. Content

owners have a variety of technologies to choose from to meet their needs and offer services that meet consumers' needs, and we expect more and more progress in this area.

Question 4: The premise of this hearing is that digital content is coming soon to digital devices to be enjoyed by consumers soon. Based on our discussion today, how soon is soon, and when will the promise become reality?

Answer: The answer to the question of "How soon?" is that digital music content is here now. All of the major record companies have made digital downloads available to consumers, and record companies have licensed streaming by interactive and noninteractive webcasters. Record labels have made deals allowing Internet services to construct compilation compact discs, and for "kiosks" that further the distribution of digital music. Although not yet "here," MusicNet and Duet subscription services will be launched later this year, and more new and exciting services will follow as record labels continue to seek new outlets for electronic distribution of their recordings.

Criticism of the industry for not making enough recordings available online through enough different outlets faster is unfair. The recent economic downturn and shakeout in the technology sector illustrate that very few companies have figured out how to run profitable businesses distributing content online. Production and promotion of material that consumers want is expensive, and large scale online distribution is expensive too. Over the last few years, some companies were able to finance content production and distribution for a time through equity investment in a superheated stock market, but for the production and distribution of content to be sustainable, there has to be a profitable business model. Record companies should not be blamed for not finding enough profitable ways to distribute recordings online five years ago, when even today very few businesses have found sustainable business models for online distribution.

Question 5: Is there any point you feel should be raised or that you would lie to further respond to for the completeness of our record?

Answer: The marketplace is working to bring digital music to consumers now. And the market forces that are bringing artists, record labels, technology companies and online services together to satisfy consumer demand really are the ideal solution for everyone involved. Only the marketplace provides the flexibility to experiment with service offerings, business models and contractual arrangements to adapt to consumer demand. By contrast, regulation would make it more difficult to take advantage of opportunities offered by new technologies and to meet the evolving demands of consumers. This is because any regulatory framework would create barriers to offering services other than those envisioned by the regulations and hamstring record labels and online services in developing and offering innovative services in response to consumer demand. It is for similar reasons that Congress has been reluctant to regulate the Internet in general. Digital music services should not be the exception to this wise rule. Because the market for digital music is nascent, it is critical that digital music services develop and adapt while the market matures without the heavy hand of government regulation.

Question 6: Do record companies have problems granting blanket licenses to third parties for digital distribution of an artist's recordings or settling lawsuits because of agreements with artists, such as "coupling" restrictions in their recording agreements (coupling is compiling an artist's recording(s) together with master recordings by other artists) such that the record companies would need the artist's approval to do so? Does a record company have the right to distribute an artist's recording absent the accompanying artwork without an artist's approval under most recording agreements? If they don't, how can they do so via digital distribution?

Answer: Artist contracts vary from label to label and artist to artist. My general understanding is that the vast majority of artist contracts do not contain limitations that would prevent record companies from licensing their recordings for digital distribution, with or without the associated cover art. And where such limitations exist, we can all be certain that discussions are or will be taking place between those labels and individual artists. Such limits have not prevented record companies from making the vast majority of the songs in their catalogs available for licensing, nor from settling the major labels' case against MP3.com.

Question 7: Has there been any discussion or consideration about the basis on which record companies will share with artists monies they receive from blanket licensing, damage awards, or equity stock participations they receive from third party companies?

Answer: Section 114 of the Copyright Act provides the answer to this question. A record company's receipts from the statutory license are to be allocated in accordance with the statute, and in other respects, artists are to be paid in accordance

with their contracts. Moreover, record labels recognize that their relationships with artists are critical to their success, and so sometimes renegotiate contracts or make other payments to artists even when not required. For example, all of the major labels we represented in the MP3.com case have stated their intention to pay artists their fair share of those damages. Universal has publicly announced that it will pay its artists half of the damages it received from MP3.com.

Question 8: Hank Barry of Napster referred in his testimony to the RIAA's pending petition before the Copyright Office that a compulsory license is precisely what's needed in order to permit RIAA's members secure necessary rights from music publishers. Could you elaborate on the meaning of your petition and explain why, in your view, such relief should not be afforded to other parties seeking to obtain other copyright rights from your member companies or clearing publishing rights in the manner you suggest in your petition? Could you also further elaborate your point about distinguishing the "core distribution right" from the other compulsory licenses cited as precedent, including the mechanical license you seek to take advantage of?

Answer: The characterization of our Copyright Office petition in this question is incorrect. A compulsory license is not needed; one has existed for almost a century and been fully embraced by the copyright owners whose works are subject to it. Indeed, it is the music publishers, not the record companies, who insisted that the compulsory license be extended to electronic delivery in 1995, because music publishers have structured their business practices around the compulsory license and have consistently opposed efforts to eliminate the compulsory license in international treaty negotiations. The only question is how that license applies to certain types of digital music services. RIAA's petition asks that the Copyright Office initiate a rulemaking to clarify how the mechanical compulsory license applies to two types of music delivery methods, "OnDemand Streams" and "Limited Downloads." Uncertainty concerning that question has been a significant impediment to the launch of subscription music services by record companies and their licensees. The petition also asks the Office to promulgate interim rules with streamlined procedures for obtaining mechanical licenses, because the Office's existing regulations require a procedure that is poorly suited to Internet licensing, and more cumbersome than it needs to be given the authority Congress has given the Office to make rules to implement the compulsory license. Whatever relief record companies might receive from this Copyright Office proceeding would apply to anyone seeking to clear publishing rights by relying on the existing mechanical compulsory license. A more complete statement of our views on these issues is set forth in RIAA's attached comments on the Copyright Office's Notice of Inquiry.

By contrast, we believe that a compulsory license for the reproduction and distribution of sound recordings is unnecessary and unwise. The marketplace is working to bring digital music to consumers now. Record companies are licensing their sound recordings for use on the Internet regularly and have signed dozens of deals already. A fundamental underpinning of the market for sound recordings is the record companies' exclusive reproduction and distribution rights. These are "core" rights because they are existing rights covering the core business of record companies—distributing copies of their recordings in whatever media consumers then demand. The industry has developed in reliance on the fact that record labels have the exclusive right to reproduce and distribute their records. These rights have encouraged record labels to discover and promote new artists and take risks, knowing that if they do discover an artist that the public likes, they can make creative and business decisions about how to commercialize that artist's recordings to make a fair profit on their investment. Without exclusive rights, recordings would become a commodity, and record companies would be far less willing to take chances and record new material, and to make a promotional investment, if others could skim the cream of their catalogs and sell the most popular recordings for the same compensation to the copyright owner as less popular recordings. Thus, taking away the most important rights record companies have in their sound recordings would cause great disruption to the recording industry, which could only limit the variety of new music available to the public and reduce the opportunities available to artists.

Creation of a compulsory license for sound recordings now would be very different from creation of the mechanical compulsory license in 1909. Music publishers never had the exclusive right to reproduce and distribute recordings of their songs; the grant of that right in 1909 was limited by the compulsory license. Before that time, the core business of music publishers was publishing sheet music. Thus, in 1909, creation of the mechanical compulsory license only provided incremental revenue to publishers, and caused no disruption of the music publishing industry. As the sale of records eclipsed the sale of sheet music, and the compulsory license has become the dominant source of revenue for music publishers, the modern publishing industry has grown up around the compulsory license and fully embraced it. That is obvi-

ously not true of the recording industry, which always has enjoyed exclusive rights with respect to its recordings. Congress should not risk the vitality of the most vibrant national recording industry in the world by creating a compulsory license now that goes to the heart of the industry's existing rights and business.

Question 9: During your testimony you displayed for the Committee the home pages of a number of current web-based music services, which your member companies, you testified, have already licensed. The implication of your statement appeared to be that such licensing activity has already gone on a long way to satisfy consumer demand. Would you please, for the record, provide the Committee with details as to which services your members have licensed, whether they had officially launched by the date of your testimony and, if so, approximately how many "customers" they each had at that point. Could you also detail, please, whether the licenses generally provided these services required the service provider to furnish customer data to the licensor and, if so, what kind of data?

Answer: Attached is the list of websites and services licensed by RIAA members, as presented in Hilary Rosen's testimony. All of these sites had launched before the date of the hearing presentation. Please note that this is a list of just some of the services and sites that our companies have licensed. The RIAA is not involved in its members' licensing deals because each company negotiates its agreements individually. We therefore do not have a comprehensive list of all licensed services and do not possess specific information about what kind of data, if any, is provided under such agreements.

Licensed Music Sites

www.2ksounds.com	www.mtvi.com
www.akoo.com	www.musicbank.com
www.aolmusic.com	www.musicbrigade.com
www.artistdirect.com	www.musicchoice.com
www.clickradio.com	www.net4music.com
www.ecastinc.com	www.oen.com
www.echo.com	www.ondemanddistribution.com
www.e-greetings.com	www.radiowave.com
www.farmclub.com	www.real.com
www.hob.com	www.rioport.com
www.ichoosetv.com	www.soundbuzz.com
www.intertainer.com	www.starmedia.com
www.launch.com	www.streamsaves.com
www.liquidaudio.com	www.supertracks.com
www.listen.com	www.touchtunes.com
www.loudeve.com	www.vidnet.com
www.moontaxi.com	www.vahoomusic.com
www.mp3.com	

Question 10: Your testimony made clear that you do not believe compulsory music licensing for interactive services to be necessary or desirable, citing MusicNet and other recent licensing initiatives by major record labels as evidence that product is beginning to flow to the market. What is your reaction to the suggestion of a sort of "Most Favored Nation" statute, similar to the program access rules for subscription television licensing, that required large copyright holder entities that engage in cross-licensing of their catalogs to make the licensed materials available on essentially the same terms and conditions to, for example, similar internet-based music distribution or "locker" services?

Answer: A government-mandated "most favored nation" ("MFN ") requirement would be a straightjacket on the marketplace for digital music. We also believe it will stifle technology rather than encourage innovation. The Internet provides nearly limitless opportunities for digital music distribution, and with these opportunities come a similarly limitless number of ways bargains may be struck among artists, record labels, and digital music services. Deals might combine online licensing with bricks and mortar retail opportunities. A transaction might take advantage of a particular consumer niche, involve a less popular musical genre, or launch an innovative strategy. And labels often strike special promotional deals. It would be very difficult to structure a government-mandated MFN requirement that recognized any of this complexity, and it would be a bad idea to try.

If an MFN requirement were imposed, record companies could never take chances, experiment with new ideas, support new services, structure special deals, or reach out to niche markets. Knowing that a concession in any one deal would become the least common denominator for all other deals, record companies would be forced to establish standard terms from which they could not deviate in individual instances without consequences across all their deals. Thus, the result of an un-

precedented MFN requirement would be to stifle competition and business creativity; limit the flexibility of artists, record labels and service providers to offer consumers innovative digital music services; and ultimately, limit consumer choice.

Question 11: We all worked together on a return to the status quo on the status of sound recordings as works-made-for-hire. Do any of you have any thoughts on how we might further revise the law to avoid litigation on that issue in the future?

Answer: As hard as we worked to return the works-made-for-hire issue to the status quo, litigation over the issue may be unavoidable. Work for hire provisions have been included in recording agreements, and in agreements between artists and their producers and musicians, for decades. At the moment that recordings were created pursuant to those agreements, authorship was determined, and certain rights vested, based on the law that existed at the time. Congress may not have the legal authority to change those rights, such as by determining that someone who had been an author for decades no longer is, and indeed never was. Participants in the recording industry reached their agreements based on their understanding of the law as it was when they made their deals. It would not be fair to upset their expectations retroactively. (Notably, the 1999 amendment clarifying that sound recordings are eligible for work made for hire treatment did not purport to be retroactive.)

Each contract, and the circumstances surrounding the creation of each recording, are unique. This means that, at least until there are some precedents in this area, courts will likely have to make case-by-case determinations of who is the author of a particular recording—whether it be the record label alone because of a work made for hire agreement, the featured recording artist alone (either because of a work made for hire agreement or an interpretation that the featured artist is the sole author), or some combination of the label, featured artist, producer, background musicians and vocalists, engineers and technicians. The desire to create a new provision parsing out creative contributions among participants and determining a new definition of who the creator might be simply proves the point we made all along during the dispute last year. Avoiding disputes among all these contributors to the creation of a recording is exactly the reason we believed, and still believe that sound recordings are eligible for work made for hire treatment; any other result inevitably will lead to litigation among claimants to rights in successful recordings. Since it would be impossible in our view to develop a statutory definition of the rightful creator (in some cases, it might be the producer, in some cases the musicians, in others the featured artists and in others the royalty artist or artists, etc.) these issues are best left to contract. The only thing the statute should articulate is whether or not sound recordings are eligible to be considered works for hire. The decision to create a work for hire has always been left to and should continue to be left to individual creative participants. Creative participants may freely decide whether or not to agree that their contribution is a work for hire or not. They have been making this decision for decades already in their recording agreements.

SUBMISSIONS FOR THE RECORD

Statement of American Federation of Musicians of the United States and Canada, Steve Young, President

As the President of the nation's largest organization representing musicians—the American Federation of Musicians with over 100,000 members—I have one important message for the members of this distinguished Committee, the representatives of the business community who will be speaking today, and all the fans of music, on-line music services, and music file sharing who are gathering in Washington to listen and to express their views:

PLEASE REMEMBER THE ARTISTS!

All the varied forms of music loved by ardent music fans, all the highly-successful businesses created by the recording industry, and all the online music services that are trying to emerge in this new digital era have one thing in common: they depend, utterly, on the creative energy of the artists who make the music.

If those artists—including royalty artists, session musicians, and background vocalists—cannot make a decent living by making and recording music, this nation's staggeringly rich output of artistically varied, high-quality recorded music will not be able to continue. There will be less music for fans and music lovers.

Before we as a nation decide what the new models for music distribution should be, it would be wise to examine the old models and consider how they can be improved to enhance the ability of artists to survive and create.

Most musicians who record music toil for many years but do not become rich celebrities known throughout the nation. Artistic talent, hard work, and loyal fans do not guarantee great financial success. Many incredibly talented musicians may make only a modest living.

Musicians who record under the industry-wide collective bargaining agreement negotiated by the union receive scale wages for their time in the studio (including pension contributions), and Special Payments Funds payments based on record company contributions and a formula tied to industry-wide sales. These Special Payments Fund payments are a critical part of the musicians' compensation structure, especially for those who do not have royalty contracts with a record label. If record sales decline, they will decline also. Most musicians cannot afford such a loss.

Musicians who obtain royalty contracts from the record companies also derive important income from the sales of their records—if their records sell enough to recoup the costs of making the record in accordance with the terms of their royalty contracts. Royalty artists should be able to choose whether or not they want to offer their music via online services that may reduce the sales of their recordings.

One thing historically missing from the income of all musicians whether royalty artists or session musicians—is compensation for the commercial broadcast of their recorded works. Because historically there was no performance right in sound recordings, musicians received no income from that form of exploitation of their work. The American Federation of Musicians always believed that to be a great injustice, and lobbied for years for amendments to the law. At the dawn of the digital era, the American Federation of Musicians fought for the creation of the Digital Performance Right in Sound Recordings Act, which became law in 1995. The union fought for, and that Act established, the principal that musicians and vocalists should share in any income streams that derived from the new digital performance right.

Artists must share in the revenue—that is the principal that the old and new business forms must recognize. That is also the principal that music lovers and fans must embrace—artists must have an income, if there is to be art.

Whatever old business models remain and whatever new business models emerge, the future of our artists depends on their ability to earn a decent income, one that shares in all the income streams their creative works generate. I hope and believe that music fans will willingly pay for music in order to support the artists whose work they love.

Please remember the artists!

Statement of American Federation of Television and Radio Artists, Ann Chaitovitz, Director of Sound Recordings

INTRODUCTION

My name is Ann Chaitovitz, and I am the Director of Sound Recordings for the American Federation of Television and Radio Artists (AFTRA). On behalf of the over 80,000 performers and newsmen in AFTRA, I appreciate the opportunity to submit this testimony on behalf of performers because new technology presents many challenges, as well as many opportunities, for performers. As a result of this Committee's leadership and our country's intellectual property laws, America creates the pre-eminent entertainment in the world and entertainment product is our leading export. In order to continue producing the finest and most sought after artistic creations in the world, the U.S. must ensure that artist incentives to create are nurtured, artists are fairly compensated for the exploitation of their work and that present and future streams of income are shared with the creators.

Music, motion pictures and other entertainment products are marketed to the world by major American industries with many contributors and participants. But individual artists—singers, musicians, writers, actors and other creators—are at the heart of the success of these major industries. It is the talent, training, dedication and creative verve of these individuals that make the original works of art upon which our successful industries are based. The artistic community now faces one of its most serious challenges. New technological services enable people to obtain these artistic creations without payment of any sort to the creators and owners of those products. Should this trend continue, inevitably sales will decrease and the direct

income earned by artists will be reduced significantly. That reduction in earnings will also decrease or even eliminate performers' health and pension benefits.

AFTRA supports the development of new technologies. Technology will allow our members' creative talents to be disseminated to an ever-increasing audience and that, we believe, benefits everyone. AFTRA, however, also strongly believes that the new technologies should not result in detriment to our members and that these new methods of dissemination should provide compensation to copyright owners and creators of sound recordings.

AMERICAN FEDERATION OF TELEVISION AND RADIO ARTISTS

AFTRA is a national labor union representing over 80,000 performers and newsmen that are employed in the news, entertainment, advertising and sound recording industries. Our membership includes television and radio performers and approximately 15,000 singers, rap artists, narrators and other vocalists on sound recordings ("Singers"), including roughly 4,000 Singers who receive payments for the sale/distribution of each recording pursuant to a royalty contract ("Royalty Artists") and 11,000 singers who are not signed to a royalty contract ("Background Singers"). On behalf of the 15,000 Singers that it represents, AFTRA negotiates the AFTRA National Code of Fair Practice for Sound Recordings (the "Sound Recordings Code"). The Sound Recordings Code has been signed by an approximately 1200 record labels, including all of the major labels. Under the Sound Recordings Code, signatory record companies are required to contribute amounts to the AFTRA Health and Retirement Funds on behalf of the Singers who perform on a recording. Those contributions are based upon a percentage of each individual Singer's earnings. The AFTRA Health Fund provides health benefits to Singers who reach certain threshold levels of earnings upon which contributions are made by the record labels. The AFTRA Retirement Fund provides pension benefits to Singers based upon the amount of the individual Singer's earnings throughout his/her career. In short, the health and pension benefits that each Singer receives are dependent upon the amount of earnings on which employer contributions are made.

In addition to bargaining and administering the Sound Recordings Code, AFTRA also actively participates in all facets of public policy development effecting our membership, frequently pursuing national and international legislation and treaties that protect Singers' rights, as well as joining issues in litigation that are critical to our memberships' interests.

SINGER COMPENSATION

Many people harbor misconceptions about the music industry and performers and how performers are paid. Basically, as the name implies, in addition to the small session fee required by the Sound Recordings Code, Royalty Artists receive a royalty for the sale or distribution of each recording and do not receive a fee for making an album. In fact, the Royalty Artist must pay for all of the production costs of the album, 50% of the independent promotion costs, 50% of the costs of videos and 50-100% of the tour costs. Artists often pay these costs with the help of an advance from the record company. However, artists must pay back their advances before they receive any royalty shares earned by their albums. This is called "recoupment." Taking into account all the deductions, royalty artists generally receive between \$0.80 and \$2.40 for each recording sold, depending on the level of success of the artist when the royalty contract is signed. What often is not understood is that the artist does not receive any of this royalty money until the recording company has recouped these costs. It usually takes two or three years before even a successful artist receives his or her first royalty payment. As Sheryl Crow stated in a response to a question from Congresswoman Bono at a May 2000 House Judiciary Committee hearing, she did not receive any money until after her record had sold "three or four million copies." And, very few records ever sell this many units. As an example, in 1999, nearly 39,000 recordings were released, but only 3 singles and 135 albums—0.35%—were certified as selling three million units, and notably, many of these records had been selling over a number of years before finally reaching the three million unit sales mark in 1999. And, 77% of the 39,000 recordings sold less than 1000 units.

Under the Sound Recordings Code, background singers receive a session fee for their work in the recording studios and also additional payments if the records on which they perform reach certain sales plateaus. However, most records never meet any of these plateaus. Thus, all Singers are compensated based on the sales of their recordings, and any decrease in record sales volume would directly and adversely impact both Royalty Artists and Background Singers. The decrease in earnings that would result from any decrease in recording sales volume will result in a cor-

responding decrease in the pension that a Singer would receive upon retirement and, further, may jeopardize a Singer's eligibility for individual and family health coverage altogether.

THE FUTURE

In a society that treasures creative work, the artists' incentives to create should not be thwarted by the advent of new technologies. Many professional singers struggle to earn a living from their recorded performances. Even for those relatively few singers who have successful careers, almost all spent years struggling economically while they were honing their craft, building their careers and trying to obtain a recording contract. These singers deserve to have their work protected and be compensated whenever anyone exploits it by whatever means, analog or digital, new technology or old. However, digital product and new technology presents a more serious threat to creators' livelihood because millions of people may have free access to a work. If Congress permits this piracy, American artists will suffer, and we risk not only our ability to continue creating worldrenowned masterpieces but also our balance of trade.

Again, we appreciate the opportunity to submit this testimony and look forward to working with the Committee and its staff as it addresses these copyright issues that are fundamental to our membership.

AMERICAN FEDERATION OF TELEVISION AND RADIO ARTISTS

AFTRA urges Congress to protect recording artists from piracy of their works

Washington, D.C., April 3, 2001—The artistic community now faces its most serious challenges as new technological services enable people to obtain their artistic creations without payment to the creators and owners of these products. If this trend continues, sales will decrease and the income earned by artists will be reduced significantly, also decreasing or even eliminating performers' health and retirement benefits, according to testimony by the American Federation of Television and Radio Artists at today's hearings before the Senate Judiciary Committee in Washington.

In its testimony before the Committee, which is considering Online Entertainment and Copyright Law, AFTRA, which represents 80,000 performers and broadcasters, including 15,000 singers, addressed the many misconceptions about the music industry and performers, and how they are paid. In addition to the small session fee required by the AFTRA Contract, Royalty Artists receive a royalty for the sale of each recording, but they "do not receive a fee for making an album," said Ann Chaitovitz, AFTRA's Director of Sound Recordings.

"In fact," said Ms. Chaitovitz, "the Royalty Artist must pay for all of the production costs of the album, 50% of the independent promotion costs, 50% of the costs of videos and from 50% to 100% of the tour costs. Artists often pay these costs with the help of an advance from the record company. However," Ms. Chaitovitz said, "artists must pay back their advances before they receive any royalty shares earned by their albums." Sheryl Crow has stated that she did not receive any money until after a recording had sold "three or four million copies."

"Few records ever sell this many units," Ms. Chaitovitz told the Committee. "In fact 77% of the 39,000 recordings released in 1999, for example, sold less than 1,000 units."

"While AFTRA supports the development of new technologies," Ms. Chaitovitz said, "digital product and new technology presents a serious threat to creators' livelihood because millions of people have free access to a work. If Congress permits this piracy, American artists will suffer, and we risk not only our ability to continue creating world-renowned masterpieces but also our balance of trade."

AFTRA has contracts with 1,200 recording companies, including all of the major labels.

April 2, 2001

Jim Griffin
CEO, Cherry Lane Digital
Museum Square
5757 Wilshire Blvd., Suite 401
Los Angeles, CA 90036

Dear Jim:

We have reviewed your White Paper “IMPASSE: TECHNOLOGY, POPULAR DEMAND, and TODAY’S COPYRIGHT REGIME.” We are two professional economists expert in markets, organization, strategic behavior and growth. Central to our research is the role of innovation in fostering growth and prosperity. Our current endeavor focuses on the determination of the system of property rights most favorable to production and diffusion of intellectual innovations. This has lead us to support a strong protection of the right of creators to sell their work, because this is crucial to provide the financial incentives needed to assure a continued flow of artistic creations and innovations. However, we are highly skeptical about the need for restrictive copyright protection after the first sale. The points you make in your paper are similar to those we have made in our own research: we endorse the recommendations you make. If implemented, they would open the way to a more efficient and socially useful system for copyrights protection and distribution of artistic products. Allow us to elaborate briefly on the most relevant issues.

CURTAILMENT OF THE DIGITAL DELIVERY OF MUSIC

You argue persuasively that the current copyright law, as applied by the courts, will lead to the curtailment of digital delivery of music. You also argue, and we find this crucial, that the current situation of impasse is not sustainable, that it is damaging both to American consumers and the overall economy, and that, due to continuous technological advances in this area, a substantial reconsideration of copyright legislation is urgently needed. We also agree with you in calling attention to the anti-trust problems generated by the ongoing attempt of the “majors” to coordinate in establishing a music-delivery business and to collude in preventing the entry of independent competitors. Vigorous competition, especially following major technological breakthroughs such as the Internet is crucial in stimulating innovation and in providing better products at lower prices. In the long run the new delivery technology should lower barriers to entry and lead to cheaper and more varied music (and arts) accessible to a wider audience. Current efforts by the majors, if successful, may severely tilt the playing field in their own favor. This would prevent new companies from providing such services and stop superior delivery technologies from being adopted. Encouraging innovation by new companies such as Napster instead strengthens the technological leadership upon which the increasing wealth of American households is built.

TRANSACTIONS COSTS

Quite correctly, you compare the reduction of transaction costs achievable through peer-to-peer networking to the increase in such costs caused by ongoing byzantine attempts to control, monitor and neutralize the economic impact of the Internet technology upon established monopolies. Economists widely recognize the effort by incumbents to suppress new technology as one of the most significant social costs of market concentration. In the long run, such efforts are seldom successful. Still, they delay the social benefits of new technology in the meanwhile, and lead to the development of wasteful and undesirable black markets. Incumbents’ efforts not only increase current transaction costs but also paralyze future progress: newer products and techniques are always fed by the ongoing adoption and experimentation of previous ones.

FAIR USE

You observe that efforts to prevent piracy also prevent fair use. This is one of the most insidious consequences of overprotecting intellectual property. Fair use constitutes the core of consumer sovereignty. Producers of any kind, and those of intellectual property in particular, always profit from greater market power, and for this reason have always argued against fair use. Congress and the Supreme Court have wisely resisted this pressure, recognizing that eliminating fair use serves no broad economic purpose and thwarts the copyright laws' goal of maximizing the use and enjoyment of protected work. Given that Napster and related technologies have had little impact on the profits of the majors, it is hard for us to avoid the conclusion that much of what is being sold as an effort to prevent piracy is in fact an effort to prevent fair use and so increase future monopoly power. We are especially concerned about the economic consequences of adding copy protection to multi-use devices such as computers. Complex software and hardware invariably have bugs. While buggy VCRs and DATs pose little threat to economic growth, the loss of data and time from buggy hardware and software in computers can lead to significant economic harm.

STATUTORY LICENSING

Your paper supports consideration of statutory licensing, correctly pointing out that these schemes are already widespread under circumstances similar to those involving Napster. Indeed, the music industry itself is arguing for statutory licensing for music broadcast over internet radio. Statutory licensing seems to us a sensible middle ground between the extreme copyright protection demanded by the currently dominant firms and a competitive system based only on the right of first sale. While, in our view, it will not be the final answer to the momentous problems generated by ongoing technological innovation, it does constitute an important step in the correct direction. We want to emphasize that mandatory licensing will reduce incentives to piracy and the black market generated by the current, unsustainable, status quo.

Overall then, we support your effort and that of Napster to improve existing copyright law to better "promote the progress of science and the useful arts."

Best Regards,

MICHELE BOLDRIN
Professor of Economics

DAVID K. LEVINE
Armen Alchian Professor of Economics

Statement of Broadcast Music, Inc.

Broadcast Music, Inc. ("BMI") is a music performing rights licensing organization ("PRO") that represents approximately 350,000 affiliated songwriters, composers and publishers, in licensing the public performing right in approximately 4.5 million musical works, including many thousands of foreign works through BMI's affiliations with over 60 foreign PROs. BMI has been a proponent of strong copyright protection for the rights of authors and creators for decades. BMI believes that copyright must be protected on the Internet in order to foster the creation of music. To this end, BMI participated in the negotiations that led to the U.S. signing of the WIPO Copyright Treaty and the subsequent enactment of the Digital Millennium Copyright Act of 1998. These laws adopted new technological protections for copyrighted works online and clarified the copyright responsibilities of Internet service providers in order to make a more stable environment for the commercial delivery of music and other copyright content in the online world.

BMI has been a pioneer in licensing copyrights on the Internet and in digital transmission technologies. In April 1995 BMI announced the first commercial copyright license for music on the Internet, a blanket public performing right license with On Ramp, Inc. Since that time, BMI has entered into license agreements with over 1,000 web sites, including such well known sites as Yahoo!broadcast.com, NetRadio, Spinner.com, MP3.com, Emusic.com, GetMusic.com and FarmClub.com. Since the beginning BMI's Internet license has covered the public performing right involved in both the downloading of music files as well as the streaming of music either on demand or as part of archived or regularly scheduled programming. BMI's

licensing experience has proven that licensing is an effective solution to the problem of protecting creators' and copyright owners' rights and ensuring copyright owners obtain commercial reward for the widespread exploitation of their works by online music users.

BMI has embraced new digital technologies that facilitate the licensing of online transmissions of musical works. Last year BMI announced a new "Digital Licensing Center" that allows users to obtain BMI licenses through a simple click-through system available on BMI's award-winning web site, BMI.com. These efforts will make licensing particularly accessible and easy for small webcasters. BMI is also utilizing digital technologies to enable its licensees to submit reports and statements online, permitting faster processing of information that will permit a dramatic increase in the speed of payment of royalties to writers and publishers.

One of the most compelling aspects of the Internet is its international scope. BMI has responded to the challenges posed by the dimensionless nature of cyberspace by negotiating pioneering global rights agreements with over 20 foreign PROs, including the major European societies. As a result of these agreements, BMI now can offer users seamless licenses that cover transmissions of BMI's repertoire of works that cross national boundaries.

Peer-to-peer file sharing services like Napster are only the latest in a long line of challenges presented to the music industry and the copyright community by the Internet. BMI is pleased that the courts have recognized that unauthorized peer-to-peer file sharing constitutes copyright infringement. Unregulated by law, the Internet has the potential to become the largest "swap meet" for piracy of copyrighted works in history. Napster has announced its intention to reformulate its service as a licensed subscription music transmission service. BMI has been engaged in good faith negotiations with Napster over the terms of a BMI blanket license for peer-to-peer file sharing.

BMI has a long history of licensing both free over the air broadcast and subscription cable music transmission services. For example, BMI has successfully concluded industry-wide negotiations with the television industry for promotional use web site licenses for hundreds of television broadcast stations, and with the radio industry for interim licenses for radio signal streaming online. In BMI's view Napster's service shares numerous characteristics of broadcasting and cable transmissions, and if peer-to-peer music transmissions online are allowed to be "free" on the basis of a misguided notion of "fair use," in the long run established markets for public performance of music will be jeopardized. BMI is hopeful that its negotiations with Napster will bear fruit, and does not believe that a compulsory license for the public performance of copyright musical works is necessary or appropriate.

Peer-to-peer transmissions of music involve a number of different copyright rights for which Napster must seek licensing. For example, in addition to the public performing right in the musical work, such transmissions also involve the public performance right in pre-recorded sound recordings that contain those musical works. The reproduction and distribution rights in Section 106(1) and (3) in copyrighted musical works and sound recordings (so-called "mechanical rights") are also implicated by transmissions that result in copies, as the Ninth Circuit found. The recording industry has taken steps to license necessary rights to webcasters, generally, and the music publishers have as well with respect to mechanical rights.

It takes time for licensing practices to be developed. This is especially so in an environment where the business models are changing as often as the technology improves. The Berne Convention requires that copyright owners be given adequate time to develop mechanisms for licensing before exemptions or compulsory licenses are legislated, particularly where substantial vested commercial interests are at stake. BMI supports the Committee's interest in the oversight of the e-commerce in copyrighted works, and believes that the proper approach is to allow the market place to work under the auspices of the DMCA to foster a wealth of entertainment product for consumers in the 21st century.

Statement of Hon. Maria Cantwell, a U.S. Senator from the State of Washington

I want to thank Chairman Hatch and Senator Leahy for calling this hearing. The delivery of online music has become the testing ground for how the marketplace and the law can work to bring new entertainment services to the consumer.

The business of distributing music online is quite young. There is little history guiding its development.

What we can learn from history is that as every new medium developed—the printing press, radio, television—industries touched by new media were rocked—and ultimately revolutionized.

Legitimate secure online music services will be fantastic for consumers and good for the economy. Unfortunately, the public discourse has been diverted from where I believe the discussion should occur: rather than identifying ways to bring the music industry, online distributors and others with technological solutions together to resolve legal and practical questions of rights, licensing and distribution, many are focused on only one approach: Napster.

Clearly, Napster is evidence that there is extremely high consumer demand for online music delivery. But in focusing on Napster, we see the battle lines—without any sense of the productive lines of communication.

Indeed, there are significant concerns on both sides of the debate. But this doesn't mean that there have to be winners and losers. It means simply that there are issues that we need to work through in a thoughtful way. We will all benefit from the growth in the market that will result.

From the perspective of the entertainment industry, in the earlier days of online music it looked as though a few new companies were coming into the economy, taking the entertainment industry's "goods," and building businesses at their expense. Indeed, many of these claims are legitimate. I respect the importance of intellectual property rights and recognize the risk digital delivery poses. Issues of copyright and security are of utmost importance in this discussion. The threat to the music industry will become a threat to the viability of the Internet, if copyright is not respected.

From the point of view of some in the online community, the entertainment industry is simply entrenched and afraid of new technologies. This is a vigorous young industry developing extraordinarily exciting new ways to bring entertainment and information to consumers. And although the public discourse may reflect otherwise, most of those in this space are legitimate businesses trying to develop new markets in this new medium. And we must encourage an environment in which these businesses will flourish.

I would observe, that when compared with other policy arising as a result of the creation of the Internet, substantial progress has been made in the past few years. There are substantial inroads being made in bringing legitimate music distribution online.

But all of these businesses need to be building relationships. We need to be getting people to work together. Right now, it simply looks like everybody is in the "online music sandbox," a lot of sand is flying, but there is not much of an effort to play together.

There are legitimate business and technological issues that we collectively need to consider. Without question, some of the issues are arcane or technical. But we need to continue to work our way through them.

There are three ways we can approach this: (1) everybody makes the effort to work it out; (2) keep holding hearings such as this one in the hope that hearings will pressure the parties to compromise and work together; or (3) legislate the framework.

From my perspective, we need to keep moving forward to find the solutions that will bring music to consumers in a manner that will allow them to listen to music where they want, when they want. The environment should be secure, so the artists and other copyright holders are paid for their work, and the costs to the consumer should be reasonable.

Our job is to preserve the profitability that the entertainment industry has built—and take advantage of new business models and new media. We need to create a competitive environment that will give the consumers the flexibility they want in obtaining their entertainment.

We need to work together to build on the successes of each of these industries. I hope we can focus on how we can encourage solutions that bring to consumers the services that they want, and continue the enormous contribution to our economy that entertainment brings.

The differences I hear here seem to be marginal when I think of the alternatives to working together—there are such sites as BearShare, a Gnutella service, ready to compete with Napster. I know that when creative minds decide to accomplish something, they can. I hope that you will all sit down, set a realistic time-line, and work to achieving ubiquitous music delivery through legitimate channels.

I look forward to your testimony.

Statement of CenterSpan Communications Corporation, Frank G. Hausmann, Chairman and CEO, Portland, OR

Chairman Hatch and Members of the Committee, CenterSpan Communications is pleased to be able to provide its views regarding the important focus of today's hearing. Today's technology, as well as new technologies that will undoubtedly be created over the next few years, will indeed enable all individuals to have access to high-quality digital culture, media, and entertainment on-demand 24/7 from nearly any location through a variety of wired and wireless digital devices. The challenge that confronts the Committee is to determine whether the current state of copyright law empowers or detracts from our ability to fulfill that potential. The question that faces you is whether statutory change is required - and, if change is to be made, how to balance the maintenance of incentives that "promote the Progress of Science and the useful Arts", the goal set forth in Article I of the Constitution, against the technological developments that can undermine the "exclusive Right to their respective Writings and Discoveries" envisioned by that founding document.

EXECUTIVE SUMMARY

- CenterSpan's Scour Exchange is the first secure and legal service for peer-to-peer (P2P) distribution of interactive audio and video entertainment.
- P2P is both the origin and the future of the Internet.
- Contrary to the impressions generated by the Napster controversy, P2P systems are not inherently infringing or non-secure. P2P offers "viral marketing" benefits far beyond those available in central server systems. In addition, a P2P distributed environment offers substantial cost savings with respect to storage and bandwidth requirements necessary to support games, music and video.
- Existing digital rights management (DRM) technologies provide sufficient security to address the legitimate concerns of copyright owners.
- A legislated fair use "safe harbor" may be desirable in the future, but in the near-term the marketplace should be permitted to let DRM technologies provide the optimal balance between affected parties.
- New or expanded compulsory licenses for interactive media may be appropriate for "streaming" distribution that is analogous to commercial broadcasting, but not for "downloading" which enables the provisioning of permanent copies and represents the entire future of how digital content will be sold and distributed.
- The first sale doctrine is not meaningful or applicable in the digital environment.
- Consumers may require enhanced legal protections to assure that when they participate in beneficial P2P systems their legitimate privacy expectations are respected. They should not be subjected to unsolicited marketing and spamming from third party commercial entities.
- We look forward to working with the Committee as it addresses critical copyright and related public policy issues for digital media in the twenty-first century.

COMPANY BACKGROUND

My name is Frank G. Hausmann. I serve as President, CEO, and Chairman of the Board of CenterSpan Communications Corporation, headquartered in Portland, Oregon. CenterSpan is a NASDAQ-listed (stock symbol: CSCC) company as well as an Intel Capital Portfolio Company. CenterSpan is a developer and marketer of secure peer-to-peer Internet software solutions for communication and collaborative information sharing. My professional background consists of extensive computer industry experience.

Our major focus is the delivery of interactive digital entertainment. In May 2000 we launched Socket, a P2P Internet gaming application. In December 2000 we purchased the 4.5 million-customer list and other assets of Scour Exchange (SX) at bankruptcy auction for \$9 million in cash and stock. SX was a pioneering P2P system for the delivery of audio and video, but its failure to comply with copyright law resulted in a barrage of litigation and subsequent bankruptcy.

Just last week, we launched the Beta test version of the new Scour Exchange service. SX is now the first secure and legal P2P "digital distribution channel" supporting the delivery of audio and video entertainment. To date, more than 370,000 people have pre-registered to participate in the free Beta test. We intend to use the Beta test to finetune SX's offerings and technology, and anticipate the rollout of a tiered-price subscription service during the second half of this year. We plan to offer

different service options depending on the type, quantity, and “use rules” of content that subscribers wish to access. Eventually, SX will also support e-books, photos and graphics. Our proprietary market research, as well as extensive conversations with all segments of the digital entertainment world, convinces us that there will be substantial consumer demand for such a service—provided that it offers the right combination of ease of use and content.

In February 2001, CenterSpan established a Digital Media and Entertainment Group. The joint executive team of Michael Kassan and Howard Weitzman runs this Los Angeles-based unit. Mr. Kassan formerly served as President and Chief Operating Officer of Western Initiative Media Worldwide, a division of the Interpublic Group; in 1997 he was named by Advertising Age as one of the top media executives in the United States. Mr. Weitzman was formerly a senior executive with Universal Studios and a wellrespected entertainment attorney for over 30 years. Both of these accomplished executives came to CenterSpan from Massive Media Group, a developer of digital rights management (DRM) based applications and services for the entertainment and advertising markets. Together, they bring to CenterSpan an understanding of DRM technologies, and of the entertainment, media, and advertising sectors that is invaluable to our future growth. SX has already acquired licensed audio and video content from a variety of sources for use in the Beta test, and is currently in discussions and negotiations with record labels, movie studios, and other content owners to obtain top content for the launch of the fee-based service later this year. We are very optimistic that we will be able to secure a depth and variety of entertainment offerings sufficient to provide a compelling and rewarding experience for SX subscribers.

P2P: ORIGIN AND FUTURE OF THE INTERNET

CenterSpan embraced the P2P marketplace out of our belief that peer-to-peer networks and applications are both the origin and the future of the Internet. The Internet’s fundamental support of a widely dispersed and virtually limitless number of participants, coupled with the transmission of digital information through packet switching that breaks up messages and content and sends it between users via multiple routes, was chosen to assure the maintenance of communication regardless of attacks on any single component of the system. The result is the most robust, resilient, and useful communications system in history.

CenterSpan believes that Internet media business models that rely solely on content distribution from central servers, and do not support or further dispersal by individual users, will not be as successful in the marketplace. Most such systems are unable to take advantage of the “viral marketing” that occurs when fans enthusiastically promote and share their secure digital entertainment files with others. Where video and gaming content is concerned, the significant storage and bandwidth requirements are best and most efficiently met through the dispersal of content to end-users within a P2P environment. In effect, P2P systems enable consumers to choose to make a portion of their hard drive storage and bandwidth available for other users to share.

It is unfortunate that Napster has created the public impression that P2P networks only support illegal distribution of inherently non-secure content. Nothing could be further from the truth. The courts have determined that Napster’s original design is in substantial violation of our copyright laws, and it is under mandate to comply with the Ninth Circuit’s injunction and cease its infringing activities. Napster has publicly stated its intent to develop a legal, subscription-based P2P system. On February 13, 2001, when the Ninth Circuit Court of Appeals issued its decision, I applauded that ruling and stated, “The rights of copyright holders must be protected in the new digital distribution paradigm. . . . The new Scour Exchange respects and protects copyrights and provides content owners with mechanisms to control the distribution and use of their material while profiting from it.” The Committee can rest assured that SX will demonstrate that respect for copyrights through required licensing and the utilization of advanced DRM technologies are completely compatible with the distributional and cost advantages of P2P systems.

PUBLIC POLICY VIEWS

The Committee is now engaged in a dual enterprise. Your first objective is to determine the current state of digital entertainment technology and applicable law. Your task is to determine whether near-term legislative intervention is required to protect the goals of copyright law and the rights of copyright holders while promoting the further development of digital distribution of music, movies, and other genre of entertainment and culture. As so often before, you must balance traditional legal

values with new technology that, depending on its use or misuse, may promote or undermine the progress of science and the useful arts.

CenterSpan welcomes the opportunity to contribute to that process going forward. We believe that what we have already learned in developing the first legal and secure P2P system, as well as what we expect to learn from SX's Beta test and transformation into a fee-based subscription service, can be of substantial value to your deliberations.

We find ourselves in substantial agreement with the sentiments expressed in the February 14 Senate floor remarks of Chairman Hatch and Senator Leahy in response to the Ninth Circuit's Napster decision. We concur with Chairman Hatch's call for "an open and competitive environment in the production and distribution of content on the Internet", as well as for "a marketplace resolution to . . . digital music controversies". And we are in concert with Senator Leahy's observations that "the availability of new music and other creative works. . . depends on clearly understood and adequately enforced copyright protection. . . . copyrights may not be ignored when new online services are deployed. The Internet can and must serve the needs not only of Internet users and innovators of new technologies, but also of artists, songwriters, performers and copyright holders". Each day, CenterSpan/Scour Exchange is fully engaged in the digital marketplace as we seek to legally obtain, and technologically secure, diverse content to offer to the public. We are confident that we can effectively compete and provide new benefits for consumers, creators, and copyright owners, so long as we have a supportive legal framework that sets forth nondiscriminatory and clearly understood principles for all market participants.

WE ARE THEREFORE PLEASED TO SHARE OUR VIEWS ON SOME OF THE KEY PUBLIC POLICY AND TECHNICAL QUESTIONS THAT CONFRONT YOU:

- *Security*: We believe that current DRM technologies do provide sufficient protection to satisfy the legitimate concerns of copyright holders. CenterSpan has designed its system to eventually support a variety of DRM solutions.
- *Fair Use*: CenterSpan would support the consideration of legislation to carve out a fair use "safe harbor", should it become apparent that the marketplace is not sufficiently sensitive to this key protection of informed discussion, criticism, and debate. For the time being, the marketplace is the best place to determine the reuse limitations supported by DRM technologies and is most likely to set the optimal balance between the desires of consumers, the needs of scholars and commentators, and the legitimate concerns of content owners.
- *Compulsory licenses*: CenterSpan believes it is worthwhile for Congress to consider the establishment of new or expanded compulsory licenses to facilitate the digital distribution of interactive media content over the Internet. If you take this path, it may be useful to distinguish between those forms of "digital distribution" that are analogous to broadcasting, versus those that are more akin to ownership of a CD or DVD. Digital content may be distributed via "streaming" or "downloading". CenterSpan's view is that streaming is analogous to radio and broadcast television, while downloading represents the next generation distribution channel of digital copies. This distribution channel facilitates the sale or use of permanent or quasi-permanent content, subject to the consumer's fair use transfer to other devices, be they in the home or auto, or a portable device that may be carried on their person. In our view, compulsory licensing may be more appropriate for streaming media that allows for listening or viewing but does not provide for the retention of a permanent copy.
- *First sale doctrine*: It is our view that the first sale doctrine is not meaningful or applicable in the digital environment. The doctrine makes sense for analog media, such as used books or records. But there is simply no way to adequately assure that an individual selling a "used" digital file has not retained a perfect digital copy for continued use. Whatever loss may occur from the absence of a first sale right in the digital environment should be more than offset by the lowered costs and vastly broader selection of content made possible by Internet distribution.
- *Privacy*: We applaud the continuing efforts of Chairman Hatch, Senator Leahy, and other members of the Committee to assure that citizens' concerns about online privacy are adequately addressed. If consumers believe that the use of online technologies and services is at odds with their expectations of personal privacy, then the growth of Internet commerce will suffer. While one's listening and viewing habits may not raise the same level of concern as medical and financial data, we note nonetheless that Congress saw fit to make it illegal for video rental stores to reveal the records of individual consumers.

P2P systems inherently raise unique privacy questions and challenges. A consumer who subscribes to any P2P entertainment service agrees to make a portion of their computer's hard drive viewable by and accessible to other subscribers. Thus, they have a clear expectation that their collection of digital media will be revealed to third parties, even if their identity is safeguarded. However, they may not contemplate that unauthorized commercial third parties can gain similar access and can use the information they obtain for a variety of marketing, promotional and other purposes. Even where such activities violate the P2P provider's terms of service, as they would CenterSpan's, they are difficult for the P2P service to detect and deter.

CenterSpan's own privacy policy prohibits the sharing of personally identifiable customer information with third parties, except for that information required to facilitate payment transactions. We will not allow our customers to be subjected to unwanted solicitation and spamming from unauthorized commercial third parties. Therefore, we encourage the Committee to consider whether new legal protections should be put in place to assure that the privacy expectations of P2P system users are fully respected.

CONCLUSION

CenterSpan appreciates this opportunity to share its views, market experience, and plans for the P2P future with the Committee. We look forward to working with you in the months ahead as you strive to assure that the legal and policy structure for digital media in the twenty-first century is fully relevant and strikes the proper balance between the rights and interests of all participants in this exciting and rapidly evolving sector.

Statement of Lawrence E. Feldman, Esquire, Jenkintown, PA

I. VANTAGE POINT:

I am a lawyer from Pennsylvania with over twenty years experience in general civil litigation. I also represent "catalog artists" (that is, artists no longer under contract to the record companies) in two class actions against the record industry *Chambers v. MP3.com*, *UMG et. al.*, SDNY 2000 (involving current internet use of old recordings of the 1950's through 1995 by music industry without payment; on appeal after dismissal by Judge Rakoff;) and *Moore v. AFTRA, Time Warner, et. al.* (ND.ALA 1993); (on-going RICO and ERISA suit against the record industry for illegal pension reporting practices in connection with the AFTRA health plan). I am also one of many firms involved in *In Re COMPACT DISC MINIMUM ADVERTISED PRICE ANTITRUST LITIGATION MDL Docket No. 1361*, and other litigation, including copyright and trademark litigation. I also assist musicians in running and maintaining internet websites, and I own several internet web servers. I am a former professional performing and recording musician (electric violin, guitar, banjo, mandolin, keyboards). My on-line resume is at <http://leflaw.com/leflawnet/firmresume.html>; there is an on-line article on digital music and record companies at <http://mp3.com/news/227.html>; on-line article on AFTRA class action at <http://www.addicted.com.au/MNOTW/lofi/970821/970821-971.shtml>.

I am not an entertainment lawyer or music industry lawyer per se. I consider myself a self-funded public interest lawyer and litigator. I represent no music or record companies, although I do represent webcasters.

Among the artists I represent, several have specifically endorsed the positions taken herein. They are:

- Carl Gardner of the Coasters ("Yakety Yak", "Charlie Brown", "Love Potion Number 9")
- Bill Pinkney of the Original Drifters (co-founder of the Drifters in 1953; voice of "White Christmas" in *Home Alone* (1991); Bill is a veteran of the Normandy invasion, and a Bronze star recipient.
- Damon Harris (Temptations 1971-75) ("Papa was a Rolling Stone")
- Lester Chambers of the Chambers Brothers ("Time Has Come Today", "People Get Ready")
- Tony Silvester of the Main Ingredient ("Everybody plays the fool").

Others have expressed support for the general notion of copyright reform and mistrust of the record industry, as outlined below. I will supplement this list prior to the April 3, 2001 hearing.

II. REASON FOR SPEAKING TO COMMITTEE:

A. Lack of a voice in copyright legislation for the recording artist who must depend on sale of recorded music to survive; specifically records, tapes and compact discs, since their contracts obviously provide no compensation for digital performances.

B. Continual misrepresentation by the RIAA to this committee and elsewhere that 1) they represent the interest of recording artists 2) they represent the interest of the "American" recording industry, since they represent mostly foreign corporations who do business in this country, and should have no voice in matters involving U.S. legislation or the U.S. Constitution.

C. Alarm that the Congress has given the RIAA an official role in fiscal and fiduciary matters involving webcasting royalties, because of their historical indifference to the plights of artists and consumers, their demonstrated inability to accurately account for their copyright registrations as well as their royalties due thereon, their recently exposed conduct in the Work for Hire lobbying effort, and their historical abuse and lack of concern for older artists, and their historical connection to organized crime.

D. Alarm that the Copyright Act is now, because of the two major RIAA - driven revisions of 1995 and 1998, one of the single biggest threats to privacy and freedom from searches and seizures, as evidenced by recent "Napster raids" in U.S. and Belgium, and prosecution of Jeff Levy in 1999 for running a music server. The RIAA says that the artists support this conduct. The artists at large do not.

III. MESSAGE:

Most authors and artists who you have heard of don't own the copyright registration certificate to their works. Usually the copyrights are held by a record label or publisher instead, since the artists' contract have historically contained a clause requiring them to assign all rights to the company. So when you hear a song by your favorite band being used to sell beer and cars on television, chances are that they didn't have anything to do with the endorsement: they don't own or control their own songs, or even get compensated at all, because the record company does.

Juxtaposed against this reality is the constitutional provision "Congress shall have power. . . to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." Article I, section I Clause 8 is not merely a grant of power to congress. It is also a limitation of that power. The Framers, who had just fought a war with England, were mistrustful of government sponsored monopolies like the Statute of Anne, which they saw as a limitation of the common law perpetual rights of authors, so they made it a constitutional drafting priority to make sure that Congress' intrusion to secure such perpetual rights of authors and inventors be limited in time, and be for the benefit of authors and inventors. It was not, as the RIAA says at their website, because copyright is more important than the First Amendment. It was that the limitation of copyright was more important than the First Amendment. Wheaton a Peters 8 Pet. 591 1834, <<http://press-pubs.uchicago.edu/founders/documents/al-8-8s15.html>>

In 1995 Congress enacted a statute, the Digital Performing Rights in Sound Recording Act, that gives exclusive rights in digital performances to the legal copyright owner, without providing any concomitant right of payment to the equitable owner (the artist is the equitable owner of the copyright under 17 USC 501(b),) who has no royalty provision in his contract to cover such uses, especially if his contract predates 1996, which most do.

Copyright is a bundle of rights. Congress created a new right and gave it to the copyright holder in 1995 without even stopping to think that the artist will no longer benefit because of prior assignments. The record industry's institutionalized greed and callousness is illustrated by the recent payment of "statutory copyright infringement damages" in excess of 200 million dollars, plus stock and warrants and future license fees from Mp3.com, a well known website, to the record companies, in litigation spearheaded by the RIAA for on-line use of my clients names, music, and likenesses with no payment to the artists thus far. When the artists try to sue for a declaration of rights and royalties involving the same conduct, we were unceremoniously shown the door in *Chambers v. Mp3.com, et. al.*, currently on appeal.

I believe that, as a start, the following amendments are needed:

1. *The Copyright Act, 17 USC 501b should be amended* to (a) give the artist rights to sue copyright holders in federal court for an accounting of profits or to determine title to copyright; (b) with the rebuttal presumption that a 45% split, the rate already in the statute for webcasting, was per se reasonable for uses not set out spe-

cifically in the artist contract. Present law of New York is that there is no federal jurisdiction for such an action (*Keith v Scruggs*, SDNY 1981), and many courts seem willing to let the prior assignment of copyright stand, without any compensation for new uses; (c) that any action for statutory infringement damages use the same 45% split to the artists, whether the suit be on the compilation copyright or the underlying copyrights; (d) provide that fiduciary standards control the relationship of copyright holder and artists, and that breach of fiduciary duty is a ground for rescission of the assignment.

2. *Artist Fair Use*—An artist may use a copyrighted work on which he performed or contributed copyrightable material, in any manner listed in section 106, so long as its primary purpose is to promote the career or reputation of the artist. Automatic fee shift against any copyright holder who sues an artist for infringing a work in which he performed or contributed and does not prevail. Record companies have threatened action against artists who use their own material on the internet.

3. *That digital internet performance rights do not apply to any pre-1996 recordings.* The industry should go back and renegotiate with the catalogue artists. Otherwise, it is tantamount to a taking without just compensation.

4. *Provide for automatic termination of transfer of sound recording copyrights, without formalities.* The Work for Hire controversy is not yet settled. Artists should have the masters back. Artists need this protection. Its like a trust for their old age, since the pension system is so flawed up because of collective bargaining agreement provisions regarding health and welfare by the AFTRA Union which couples health coverage with royalty payments.

5. *The RIAA (or Soundexchange or AARC or other incarnations) should not be collecting money for artists under the DCMA or the Audio Home Recording Act.* Appoint a reputable accounting firm, without specific music industry ties, or someone the musicians trust.

6. *Enact a FEDERAL RECISSION OF COPYRIGHT ASSIGNMENT ACT as amendment to 17 USC 501.* The United States District Courts should have original jurisdiction over actions to rescind an assignment or license of copyright, or any of the bundle of rights within the purview of 17 U.S.C. 106, in which a plaintiff is a creator of the copyright whose assignment or license is sought to be rescinded, and it is claimed that any conduct of the assignee towards the creator renders the assignee unfit to be a registrant of a federal copyright, within the standards of Article I section 1 Clause 8 of the United States Constitution. It should also be part of the Copyright Act that failure to publish or distribute copyrighted material for at least two years shall be a prima facie case of abandonment of copyright, resulting in a reversion to the artists/grantors.

I would be honored to submit drafts of this and other related proposed legislation, if the committee requests.

Statement of the Future of Music Coalition, Jenny Toomey, Executive Director

SUMMARY

The Future of Music Coalition is a not-for-profit think tank that advocates for new business models, technologies or policies that will advance the cause of artists. We firmly believe that the music industry as it exists today is, at a very basic level, anti-artist, and that any serious examination of a digital future must take into account the structures in place in our analog present. While the final solutions to the challenges in this space will be driven in many ways by technology and the market, there are a number of critical policy decisions in front of Congress that could make a significant difference in the lives of artists. These include:

1. Competition for collection and distribution of the digital royalty
2. Direct payment of the digital royalty to the artist
3. Fostering of non-commercial space on the radio and on the Internet
4. Ensuring artists have the right to keep their recordings in print

The Future of Music Coalition remains eager to work with any organization that shares our concern for improving the conditions for artists in these exciting times.

INTRODUCTION

More often than not, the debate over digital music distribution has left artists and their representatives sitting on the sidelines. Even today's hearing has omitted many of the organizations that have been driving the debate and have stood alone

in proposing concrete and coherent solutions to the questions that the Senate is posing. The Future of Music Coalition (FMC), for example, took the unique step of bringing together more than 600 hundred music industry leaders, technologists, consumers, musicians, academics and composers (including Senator Hatch) to discuss these very issues this past January at Georgetown University. Unless the Senate and other governmental organizations include artist organizations, like the FMC, in public discussions about the future of digital music, the public cynicism that has made peer to peer a phenomenon will continue to grow.

Increasingly, the public believes that artists are not compensated fairly. This perspective is then used as a justification for file sharing of copyrighted materials. If the average teenager believes that their favorite artists will not receive compensation for their creations, it gives them the excuse to use peer to peer file-sharing services that have no mechanism in place to compensate the artist. This is the crux of an enormous problem.

The Recording Industry Association of America (RIAA) has a confusing track record. It has publicly stated that the organization does not represent the interests of artists, but rather the interests of the major record companies. It has also stated that it is trying to protect recording artists and their creations through litigation against Napster and MP3.com. Still there has been no public explanation as to how the recording artists will participate in the large sums that have been generated by the settlements and/or judgements from these cases.

The Senate must ask the difficult questions: how are the artists being paid now and how will they be paid in the future? In other words, each time that a settlement is reached or a new lawsuit is filed, the Senate must ask: how will the artists be compensated when there is a final adjudication? Prospectively, the Senate should look at each of the digital music distribution issues and conflicts through this prism of artistic compensation.

THE SYSTEM IS BROKEN

Any serious examination of the digital future of downloadable music needs to take into account the fact that the music industry in America is fundamentally broken. In 1999, less than 1 percent of the total number of albums released sold more than 10,000 copies.¹ Commercial radio airplay is often sold to the highest bidder through a shadowy network of "independent radio promoters,"² while attempts to create new non-commercial Low Power FM stations have been gutted by Congress.³ The dreams of stardom chased by many are met head on with the sad reality that an estimated 75 percent of releases from major labels are not even currently in print, leaving artists with a huge debt to the record companies that they have no means to pay back. Meanwhile, technology companies seem content to roll out new business models and technologies without giving serious thought to how these technologies will impact artists' traditional revenue streams.

ELEVATING THE ARTISTS

The Future of Music Coalition is a not-for-profit think tank whose sole mission is to elevate artists into the middle of this debate. The FMC aims to increase knowledge about the current industry and advocate in favor of specific solutions—including policy solutions and business models—that will improve artists' ability to succeed in a notoriously (if not artificially) constrained industry. We strongly believe that an artists' agenda and a consumers' agenda are one and the same.

Ultimately, the new music industry will be defined in relation to innovations in technology and the marketplace. It is important to recognize that neither of these forces are neutral ones. There are a number of critical policy decisions that will determine how the market evolves and artists need to participate in those decisions. The FMC proposes four simple steps that will not only increase artist compensation but will also grow the size of the music market thereby creating new jobs and new sources of capital for investment. Each of these proposals will not only effectively create new opportunities in our industry but they will also enhance the shareholder value of each of the publicly traded major record labels. This is truly an opportunity to nurture and to grow the recording industry and the performing artists that make it all possible.

¹ David Segal, "They Sell Songs the Whole World Sings: Mass Merchants Offer Convenience, Less Choice." *Washington Post*, February 21, 2001, Page A1.

² Eric Boehlert "Pay for Play," *Salon*, March 14, 2001.

³ Stephen Labaton, "Congress Curtails a Plan for Low-Power Radio Stations," *New York Times*, December 19, 2000, A1.

1. COMPETITION IN COLLECTION OF DIGITAL ROYALTY

SoundExchange is the name of an organization created by the Recording Industry Association of America (RIAA) that is poised to become the sole mechanism by which all webcasting royalties will be collected and dispersed to all musicians. The Future of Music Coalition believes that artists must have the right to choose between competing collection agencies, similar to the robust competition between ASCAP, BMI and SESAC for analog performance royalties.

The Future of Music Coalition has stated a number of reasons why SoundExchange should not be the sole collector:

A. It is partisan.

It is clearly inappropriate to force independent musicians who have consciously worked outside of the major label system, and who compete with that system daily, to now go to an organization that was created by the major labels in order to collect their independently generated royalties.

B. The data is too valuable.

It is also our opinion that the transfer data (i.e. who is playing what songs, how many times, etc.) is valuable and should not be owned or controlled by the RIAA.

C. The RIAA cannot be trusted to represent artists' interests.

We believe that if the major labels are allowed any discretion in the manner by which webcasting royalties are collected, divided and paid out they will certainly exert influence in a way that benefits themselves and their constituents. Here it might be wise to remember the recent "work for hire" controversy which implicated the RIAA for requesting (and getting passed) a "technical amendment" which changed the substance of the Copyright Act to the detriment of recording artists. This change allowed record companies to claim ownership of sound recording copyrights FOREVER when previously these copyrights reverted to the creators after 35 years.

Thankfully the "work for hire" clause was identified, fought and ultimately repealed due to the efforts of a coalition of recording artists and musicians' rights groups. Still we think it would be unwise to allow such recently identified "foxes" as the RIAA or their agents at SoundExchange to be the sole guardian of the newly established "hen house" of digital royalties.

2. DIRECT PAYMENT OF ARTISTS' 45 PERCENT OF WEBCASTING ROYALTIES THROUGH THE DMCA

The language of the Digital Millennium Copyright Act needs clarification to ensure artists are paid their royalties directly.

The Problem:

As it stands now, some parties believe the DMCA language states that the entire 100 percent of any webcasting royalty should be paid first to the copyright owner (usually the label) who is then required to pay 45 percent to the performer and 5 percent to the unions.

Other parties suggest that ambiguity in the language of the DMCA implies that artists should be paid their 45 percent directly.

The Solution:

To eliminate further confusion and to guard the artists' right to their 45 percent share of the webcasting royalty, the FMC proposes an amendment to the Digital Millennium Copyright Act (DMCA). Modeled after the so-called writers' share paid by ASCAP, BMI and SESAC, the FMC amendment would establish that recording artists be paid directly their 45 percent share of all Digital Performance Royalties for Sound Recordings (DPRSR). The FMC believes that this is the first step in acknowledging recording artists as stakeholders in the use of music on the Internet.

Why should this be done?

As it stands the digital webcasting royalties are set to be administered exclusively by SoundExchange, a partisan collective created by the labels. Recently SoundExchange offered to pay the artists their 45 percent share directly—but only for the first year.

The FMC believes this is a smoke screen of false generosity. It is hardly a foregone conclusion that the money is currently controllable by the labels. If the law was meant to state that the artists get paid their 45 percent directly in perpetuity, who are SoundExchange to offer the same deal for a diminished period of only one year?

What is at stake?

A. Fear of Cross Collateralization.

If these royalties go first to the copyright owner, the labels may then attempt to cross collateralize this new money against any of the artists' accumulated label debt. If royalties are diverted in this manner, the overwhelming majority of major label artists would not see any webcasting royalties whatsoever.

B. Fear of Obfuscation.

As it stands very few artists who work through the major label system pay off their "expenses" and earn royalties. Oftentimes those artists that do recoup only learn of that fact after auditing the label. It would be dangerous to subject webcasting royalties to the same non-transparent formula that already underserves musicians in the terrestrial world.

C. The Future is Interactive—we should plan for that now.

FMC believes that it is critical that the stakeholders work together to attempt to make these statutory licenses apply to both interactive and non-interactive web uses. Impending technological advances (Tivo, etc.) already allow for interactive uses of non-interactive streams on the back end. Thus it is fair to suggest that the future of music and all "innovative" business models will be interactive.

If we do not address the issue of a fair statutory rate for interactivity now, we run the risk of a future where only non-interactive and dated business models pay the fair 45 percent statutory rate to creators. While all other interactive and forward-thinking business models pay artists in a manner that is subject to the same nebulous contractual rate that pays artists far less.

Here it is important to remember that artists' contract royalty rate is not statutory, transparent nor is it public. Traditional contract royalties begin at a much smaller "11–13 percent" and allow for that royalty amount to be further diminished through a process of unfair deductions that are standardized within the industry.

To understand this royalty reduction, multiply an 11 percent royalty rate by 85 percent for a "free goods" deduction. Then multiply it by 75 percent for a "packaging" deduction. Then multiply it again by 75 percent for a "new media" deduction. After this process of deduction, an 11 percent royalty is effectively reduced to less than 6 percent.

Non-interactive webcasting royalties pay artists 45 percent. Interactive webcasting royalties are subject to contracts. They pay artists 6 percent. At a difference of 39 percentage points, clearly, artists stand to fare far better under a statutory rate than one that is contractual. Therefore FMC suggests that it would greatly benefit the majority of artists if the statutory rate were applied to both interactive and non-interactive webcasting licenses.

3. SUPPORT FOR NON-COMMERCIAL SPEECH IN BROADCASTING AND ON THE INTERNET

In general, music is programmed for one of two reasons: to aggregate the largest possible audience in hopes of charging larger rates to advertisers (the commercial model) or because a piece of music is important enough that a broadcaster thinks it should be shared with its audience (the non-commercial model). Obviously, artists and consumers benefit from the widest number of possible outlets for their music.

Therefore, beyond taking a look at potentially illegal "pay for play" practices in commercial radio, or creating new community-based platforms like Low Power FM, there needs to be a means by which less expensive (or graduated) licenses can be granted to community based webcasters in the same manner that the performing rights organizations—BMI, ASCAP, SESAC—license community based terrestrial stations at a less expensive rate.

While it is critical that webcasters compensate creators for the value of their music, we should recognize the important contribution that community based stations make in exposing music fans to a broader variety of music.

Why is this important?

In order to webcast legally, a majority of independent Internet radio programmers have signed the Statutory Licensing Agreement and agreed to back pay royalties at the "statutory rate" from the date of that signature, once the rate is established.

It has been over two years since some of these webcasters have signed the agreement yet the rate is still undecided! There are obvious and grave concerns among independent and community based webcasters that they will be forced out of business on the day that they are presented with a back-dated bill that is beyond their means.

If this happens the FMC fears we will soon find the infinite space of the World Wide Web dominated by the same hit-driven, bottom-line mentality that currently dominates the finite terrestrial bandwidth and underserves the majority of musicians and consumers.

Consolidation of the Terrestrial Bandwidth

The commercial radio bandwidth is no fiend to the majority of musicians, nor, for that matter, the majority of consumers. In 2001, the overwhelming consolidation of the commercial radio ownership has concentrated control of terrestrial radio into very few dominant hands.⁴ The predominance of super-duopolies (more than 7 radio stations in a market owned by one company) and the resulting drive to create additional super-duopolies, has resulted in reductive, consolidated, market-driven programming and far less bandwidth space for niche or independent broadcasting on the radio dial. Both of these factors have had a grave impact on the ability for musicians to get their music in front of a listening audience.

Concentration of radio playlists

Commercial radio playlists seem dominated by a “once-removed” process of independent radio promotion that requires overwhelming investment to place songs on commercial radio. If this is true, then over 80 percent of musicians who do not choose to release records through the major label system are effectively locked out of the publicly owned but commercially licensed airwaves. It would be a disservice to artists and consumers to see this same unfair structure replicated on the web through a process of prohibitively expensive webcasting and licensing fees.

4. “AUTOMATIC” LICENSE FOR OUT-OF-PRINT RECORDINGS

Major labels commonly acknowledge that a majority of their back catalog is currently out of print. This phenomenon harms both musicians, who lose potential record sales, and consumers who find their variety of musical choices artificially diminished.

In order to address this problem, record contracts in some countries contain “reversion clauses” which allow for the return the copyright to the creator (musician) if a title has remained out of print for an established period of time. Reversion clauses frame the relationship between artist and label as an equal one where both sides have responsibilities and accountability.

In the United States there is no such reversion clause and, therefore, very little recourse for musicians who have signed away their copyrights to a label that is unwilling to keep those records in print.

In order to address this problem FMC is advocating for the creation of a compulsory or “automatic” license to enable musician signatories (or their heirs) the unquestionable legal right to license their back catalog sound recordings (at a fair statutory rate) from labels that have allowed these recordings to go out of print.

Copyright as Ante

It is standard industry practice to require musicians to sign away the rights to their copyrights in order to participate in the major label system. This means that ultimately musicians will have little to no control over the availability of their records for sale. Since mechanical royalties paid to artists from record sales make up a large portion of musicians’ income, it seems wholly unfair that they would have no recourse when their records are purposefully allowed to remain out of print.

Artists and Recoupment

Danny Goldberg of Artemis Records recently indicated that most major label artists need to sell more than 200,000 copies in order to pay back their debt to the label.⁵ However, according to Soundscan data, only 1 percent of records released in 1999 sold more than 10,000 copies,⁶ a number far short of Mr. Goldberg’s projection. Using these statistics we can assume that the overwhelming majority of major label musicians are in debt to their labels. Understanding that major labels routinely let artists’ material fall out of print, as noted above, there are even fewer opportunities for artists to recoup.

Napster’s Newest Fans

In the physical world, record store and warehouse shelf-space is finite and valuable but the virtual marketplace does not have the same physical limitations.

⁴ Lydia Polgreen, “The Death of Local Radio”, Washington Monthly, April 1999.

⁵ Danny Goldberg, “The Ballad of the Mid-Level Artist,” Inside, 2000, <http://www.tonos.com/appl/connect/commentary/jsp/danny-goldberg-1.jsp>

⁶ Segal, “They Sell Songs.”

The fastest growing demographic segment using Napster are adults over the age of 24. Research reports have confirmed that one of the major reasons that they are doing so is to access commercial recordings that are no longer commercially available. The FMC believes that allowing recording artists to make all of their recordings available to the public will lessen the public dependence on Napster, stimulate new record sales, and help achieve our goal of putting more money into the pockets of both recording artists and record labels.

CONCLUSION

Clearly, the music technology space is a difficult area for policy makers to negotiate, with evolving technologies and market forces shifting constantly. That being said, the future of Music Coalition has identified four specific areas of concern that Congress should address:

1. Competition for collection and distribution of the digital royalty
2. Direct payment of the digital royalty to the artist
3. Fostering of non-commercial space on the radio and on the Internet
4. Ensuring artists to have the right to keep their recordings in print

We firmly believe these four major items will make a tremendous difference to the lives of artists nationwide, and we look forward to collaborating with other interested parties to help build the structure that will sustain a middle class of musicians in America.

Statement of Jim Griffin, Founder and CEO, Cherry Lane Digital & OneHouse LLC, Los Angeles, California

AT IMPASSE: TECHNOLOGY, POPULAR DEMAND, AND TODAY'S COPYRIGHT REGIME

The Internet has fostered the creation of new music delivery services that provide Americans with unprecedented access to a broad catalogue of music. Consumers have responded enthusiastically. Continuing to meet this popular demand is clearly in the public interest, yet the future availability of these services is now in jeopardy. It would be unfortunate both for the American public as well as for copyright holders if peer-to-peer delivery of music were to be suppressed. If encouraged by appropriate legislation, these services can be configured in a manner that fully protects the interests of rights holders by ensuring them a steady stream of royalties. Moreover, consistent with the goals of the Copyright Act, these popular delivery services offer the potential for unprecedented growth in the creation and enjoyment of music.

In effect, the Internet is shifting the music marketplace from one for products to one for delivery services. Technological advances have fostered similar transitions in other markets in the past, and each time, the nation has opted to adjust its copyright laws as needed in order to enable competitive delivery services to face off against one another in the marketplace. Each time, consumers and copyright holders alike have benefited from the resulting expansion in the production and enjoyment of original works.

In passing the Digital Millennium Copyright Act in 1998, Congress recognized the need for legislation to foster the Internet's potential for broad dissemination, at the time and place chosen by the user, of all forms of original work. But the existing scheme for protecting and encouraging the dissemination of copyrighted material is inadequate for the changed market environment wrought by the new online world. Legislation enabling the continued development of online music delivery services, while fully protecting the interests of copyholders, is now needed.

The earlier statutes intended to encourage the use of prior generations of new delivery services should guide the way. Some of these statutes were designed to address problems created by high transactions costs when new technology offered the potential to deliver original works to multitudes of users. Some were intended to promote a nascent technology that might not, without statutory encouragement, have taken hold. Some were designed to help identify a reasonable price when the marketplace was inefficient at doing so. All were intended to promote the underlying goals of our copyright regime—to encourage the creation and broad dissemination of original works. These statutes provide a variety of examples of solutions that serve the interests of both rights holders and the public.

1. PUBLIC DEMAND FOR DIGITAL MUSIC DELIVERY SERVICES IS STRONG AND GROWING.

“Music has been at the forefront of the Internet explosion, and for good reason: The Internet offers tremendous opportunities for the music business as well as for everyone who loves music.”¹ Because music is easily transmitted in digital form, the Internet has promoted the development of new music delivery services, bringing the American public convenient access to much more, and more varied, music than has ever been possible before. The public response has been overwhelming.

Napster has grown with unprecedented speed. First available in 1999, its software has now been downloaded over 71 million times. Its appeal is broad—though designed by a college student and popular with teenagers, half of its users are over 30 years old, and they are evenly divided between men and women.² Its peak of 1.8 million simultaneous users is within striking range of AOL’s reported peak of 2.2 million simultaneous users. And its more than 10 million hits from unique addresses per day is significantly greater than the fewer than 7 million unique address visits that eBay and the Walt Disney Internet Group attract per week.³

Another software program for distribution of music and other digital files was originally posted on a website affiliated with AOL in the spring of 2000. It was removed after a single afternoon, but in just those few hours, 10,000 copies were downloaded, and today the decentralized file-sharing Gnutella software is enjoying ever-widening usage. It is also rapidly becoming more user-friendly. And there are many other means of obtaining access to music through the Internet, including Aimster, Bearshare, iMesh, and Spinfrenzy.

The advent of online music delivery services has and will fuel sales of music both as a new delivery service and in “hard copy” form. Many Napster users are willing to pay a monthly fee for continued access to the service.⁴ And many online music listeners report sampling new music using Napster or another such service, and then purchasing a CD of the music they liked.

Napster and similar services are racing to fill an entirely new market for services offering the customized delivery of music, a market just recently enabled by technological innovation. As with the invention decades ago of radio service for delivering plays and music, and then of television service by means of broadcast and later cable and satellite delivery, for delivering video performances and events, digital music service has transformed the nature of the market for the underlying copyrighted content. This transformation can be suppressed only at enormous cost to consumers and to copyright holders, who should benefit from the greatly expanded delivery of their works that the services promise. The American public’s demand for music delivery services will continue to grow. It is in the public interest, and in the interests of rights holders, to satisfy that demand. But the demand cannot effectively be met under the current statutory scheme.

2. DIGITAL MUSIC DELIVERY SERVICES MAY BE SHARPLY CURTAILED DESPITE WIDESPREAD POPULAR DEMAND.

Adverse court decisions now threaten the continued availability of digital music delivery services.⁵ Moreover, market forces, which might be expected to engender a new means of meeting the popular demand, are being thwarted by a variety of obstacles. Legislation is needed to resolve the impasse.

For two reasons, the marketplace cannot and will not provide a solution. First, the music industry, long known for close coordination among its major players,⁶ has

¹A&M Records, Inc. v. Napster, Inc., Complaints § 35 (N.D. Cal. 1999).

²July 11, 2000, Testimony of Hank Barry, CEO of Napster, Inc., before the Senate Judiciary Committee.

³See Niels en/NetRating service report for week ending 3/18/01.

⁴Pay to play, PC MAGAZINE at 67, April 24, 2001.

⁵See, e.g., A&M Records, Inc. v. Napster, 239 F.3d 1004 (9th Cir. 2001) (finding a prima facie case of direct copyright infringement); UMG Recordings, Inc. v. MP3.Com, Inc., 56 U.S.P.Q.2d 1376 (S.D.N.Y. 2000) (holding MP3 infringed copyright owners’ rights).

⁶See, e.g., Federal Trade Commission, Press Release, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market, (May 10, 2000) available at <http://www.ftc.gov/opa/2000/05/dcpres.htm> (“The Federal Trade Commission announced today that it has reached separate settlement agreements with . . . the five largest distributors of recorded music who sell approximately 85 percent of all compact discs (CDs) purchased in the United States to end their allegedly illegal advertising policies that affected prices for CDs. The proposed agreements would settle FTC charges that all five companies illegally modified their existing cooperative advertising programs to induce retailers into charging consumers higher prices for CDs, allowing the distributors to raise their own prices.”); Federal Trade Commission, *Analysis to Aid Public Comment on the Proposed Consent Order; In the Matter of Sony Music Entertainment, Inc., In the Matter of Time Warner, Inc.,—In the Matter of BMG Music, d. b. a.* “BMG

with one notable exception chosen to work to retain control of music distribution, refusing to deal with entities that threaten that control even if in the process substantial popular demand for music is left unsatisfied.⁷ Five companies—AOL-Time Warner, EMI, Sony, BMG, and Universal—control about 85% of the market for pre-recorded music.⁸ These companies are collectively known as the “majors.” The remainder of the music industry is made up of much smaller companies referred to as “independents” or “Indies.” As reflected by their collective market share, the majors dominate the distribution of prerecorded music and have done so for decades.⁹

The majors’ dominance extends beyond the distribution of pre-recorded music into both music publishing and the signing and promotion of new artists. While music publishing is less concentrated than sales of pre-recorded music, the music publishing businesses owned by the five majors control a high percentage of the most valuable song copyrights. Indeed, the two largest music publishing companies, those owned by AOL-Time Warner and EMI, alone control the rights to millions of songs.¹⁰ Although literally thousands of musical copyright owners are not affiliated with any of the major music publishing companies—including a number of independent music publishing companies—the catalogues of song copyrights owned by these entities pale in comparison to those of the major music publishing companies.

Similarly, the labels owned by the major music companies are capable of offering the most lucrative recording deals and, therefore, typically sign the most promising new artists to recording contracts. Few artists succeed in a big way without the backing of a major label, since the majors’ expansive resources and high market shares give them considerable influence over the primary promotional vehicles in the music industry, including radio and cable television channels like MTV and VH1.¹¹ For artists, the majors collectively control the gateway to the top.

Entertainment”; *In the Matter of Universal Music &c Video Distribution Corp. and UMG Recordings, Inc.*,—and *In the Matter of Capitol Records, Inc., d.b.a. “EMI Music Distribution” et al.*, (Sept. 2000) available at <http://www.ftc.gov/os/2000/09/musicstatement.htm> (“The market structure in which the distributors’ MAP provisions have operated also gives us reason to believe that these programs violate Section 5 of the FTC Act as practices which materially facilitate interdependent conduct. The MAP programs were implemented with an anticompetitive intent and they had significant anticompetitive effects. In addition, there was no plausible business justification for these programs.”) (hereinafter “Analysis To Aid Public Comment”). The individual FTC complaints and agreements containing consent orders, as well as additional materials, are available at <http://www.ftc.gov/os/2000/05/index.htm>. See also *United States v. Time Warner Inc.*, et al., 1997 WL 118413 (D.D.C. 1997) (Justice Department investigation into a series of joint ventures and other coordinated conduct among producers of prerecorded music both domestically and abroad; no antitrust challenge brought).

⁷With the exception of Bertelsmann AG, the majors have refused to license their copyrighted music to Napster. Bertelsmann has conditioned its willingness to license on Napster’s developing a technology that would ensure payment of royalties every time a song is shared. Until Napster introduces that technology, as it plans to do this summer, Bertelsmann remains a plaintiff in the infringement suit. See Record label settles out of court with Napster, San Jose Mercury News, January 26, 2001, at <http://www.mercurycenter.com/svtech/news/indepth/docs/napster012601.htm>; Kevin Featherly, *Major Indie LabelTVT Records Buries Napster Hatchet*, *BizReport*, January 26, 2001, at <http://www.bizreport.com/daily/2001/01/20010126-7.htm>. Universal’s CEO has said that his company would license a royalty-paying peer-to-peer service, but Universal has not negotiated any such arrangement with Napster to date.

⁸See Analysis To Aid Public Comment, *supra* n.6 (“The five distributors together account for over 85 percent of the market . . .”).

⁹See Analysis To Aid Public Comment, *supra* n.6 (the five major music companies “collectively dominate this market”); R. SCHULENBERG, LEGAL ASPECTS OF THE MUSIC INDUSTRY 3 (1999) (“[T]he music industry is dominated by a small number of entertainment/communications conglomerates. At the end of 1998, these were Bertelsmann, EMI-Capitol, Universal Music Group, Sony, and Time Warner, and only one, Time Warner, was U.S. owned.”).

¹⁰Warner/Chappell Music, Inc.: A Company Profile, <http://www.warnerchappell.com/cgi-bin/WebObjects/wcmusic/awc/About.woa/wa/ArticlePage.wo?articleId=443>. (“From perennial favorites such as ‘Happy Birthday,’ ‘Rhapsody In Blue,’ ‘Winter Wonderland’ and the ballads of Cole Porter to the hottest hits of recent years by such megastars as: R.E.M., Michael Jackson, Elton John, Sheryl Crow, Jewel and Madonna, Los Angeles-headquartered Warner/Chappell Music, Inc. now ranks as the premiere music publishing company in the world.” and “The company’s exhaustive catalog of songs spans the classical, standard, pop, country, Broadway, foreign, movie and television score and current hit categories . . .”); Warner/Chappell—Song Search, <http://www.warnerchappell.com/WebObjects/wcmusic/ss/index.html>. “Warner/Chappell is home to more than a million songs . . .”; *Seagram Music Unit, Universal, Makes Pact to Acquire Rondor*, 2000 WL-WSJ 3038939 (Aug.3, 2000).

¹¹John Sutton-Smith, Easy Bider, *Hits Magazine* (July 18, 1997), at <http://www.warnerchappell.com/cgi-bin/WebObjects/wcmusic/awc/About.woa/wa/ArticlePage.wo?articleId=281>. “Certainly we can always afford not to go for an act, because when you’re the size of the major music publishers, no one act has a material impact on the bottom line.” Les Bider is the Chairman and CEO of Warner/Chappell Music Publishing.

Where a small number of large firms comprise an industry their interests will frequently align and, very often, so will their business decisions and strategy. And parallel, and even interdependent, decision making has long been a hallmark of the music industry. Such behavior can be a natural outgrowth of market concentration and may occur even without what might be deemed collusive activity in violation of the antitrust laws. Even if it is not illegal, however, such “non-competitive” behavior still harms consumers, because it enables each of the majors to safely ignore consumer demand, confident that its competitors will do the same.

The ongoing litigation against Napster allows the music companies to watch one another’s business plans even more closely than usual. Their joint participation in the litigation, although likely shielded from antitrust challenge by the Noerr-Pennington defense,¹² provides each company with a picture window on the others’ strategies for dealing with the online world. Each time they consider and discuss the relief they are seeking in the litigation, and as they evaluate Napster’s billion-dollar settlement offer, each firm necessarily reveals its own plans and goals for the digital marketplace.

The majors know that the public wants the ability to access the full range of music, not just the music of one or two companies, from a single source. As they are reported to have written in another context, “[t]o be compelling to consumers . . . a service must offers tens or hundreds of thousands of songs . . .”¹³ They cannot themselves offer a single joint site for antitrust reasons. But as long as most of them remain united, they can prevent the success of any unaffiliated service by refusing to license their songs. They are insulated from market pressures by virtue of their coordinated behavior. Only if several were to defect would the others have to follow in order to remain competitive.

Why would the majors choose to prevent the development of popular digital delivery services, despite the demonstrated ability of such sources to increase public demand for music? Napster, as the innovator of peer-to-peer music file sharing technology, has earned a “first-mover” advantage over other companies in the digital delivery of music. As a threshold matter, the majors do not want to enable Napster to earn a financial reward for this innovation, but would rather try to recapture the advantage for themselves. More importantly, they fear increasing competition from independent labels. Napster does not have an interest in what, or whose, music is shared on its service—with Napster’s service, independent music is as readily available as the majors’ music. And Napster is not only a vehicle for the delivery of music, but also an open venue for the exchange of opinions and recommendations about music, entirely free of the majors’ control. For the major music companies, which dominate older music promotional channels, this would be a dramatic change. They do not want to lose their historical influence and concomitant ability to direct consumers’ attention, and purchases, to their own artists and labels.

Thus, it is in the majors’ collective interest to regain control of music distribution from upstart entities such as Napster, even after it transitions to a royalty-generating service. The concentrated structure of the music industry and the increased coordination facilitated by their joint participation in litigation enable them to assure themselves that most are pursuing a strategy that protects them all. Absent intervention by Congress, adverse court decisions and the coordinated resistance of four of the leading record companies will deprive consumers of digital distribution technology in the future. A unique opportunity for consumers to enjoy a fantastic range of original work, in a context that ensures full compensation to rights holders, will be lost.

Another reason that the unassisted marketplace will not meet the public demand for digital music delivery services is uncertainty over pricing. Customized music delivery is a wholly new service-based approach to content delivery, and it does not fit neatly into the current copyright regime. If the various legal issues are not soon addressed by legislation, considerable additional litigation is likely to ensue, regarding fair use, first amendment rights, and more; as a result, absent legislation, the pricing picture is not likely to be clarified anytime soon. In this environment, it will be difficult if not impossible for new services to succeed, and their failure would leave public demand for these services unmet.

3. When faced with similar problems in the past, Congress has enacted legislation to foster development of new delivery services while ensuring that the interests of copyright holders are protected.

¹² See *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

¹³ Jeffrey Benner, *Record Industry Plays Both Sides*, WIRED NEWS, March 16, 2001, at www.wired.com/business/0,1367,42426,00.htm1 (March 16, 2001) at 13.

With some frequency over the past century, new technology has enabled the creation of new delivery services for copyrighted works, while at the same time creating new inconsistencies and inefficiencies in the existing copyright regime. Each time,

Congress has responded by enacting legislation that encourages the maximum development of the new delivery services, but also protects the interests of rights holders.

Each of these examples can be best understood as a Congressional response to the transformation, through new technology, of a market for protected works sold in the form of products into a market for the sale of services delivering those works to consumers. Each time, Congress has acted to protect the rights of copyholders in the works themselves, while ensuring competition among services that deliver those works.

The Supreme Court has written, “[f]rom its beginning, the law of copyright has developed in response to significant changes in technology. . . . Repeatedly, as new developments have occurred in this country, it has been the Congress that has fashioned the new rules that new technology made necessary.”¹⁴ Not every technological change, of course, necessitates a corresponding change in the copyright laws. Indeed, were this the case, Congress would get very little accomplished other than amending the copyright laws. When, however, in light of new technology, the boundaries of existing copyright law are inadequate to promote the widespread distribution of works that the copyright regime encourages, Congress fashions an appropriate legislative solution.¹⁵ “Sound policy, as well as history, supports . . . [the courts’] deference to Congress when major technological innovations alter the market for copyrighted materials. Congress has the constitutional authority and the institutional ability to accommodate fully the varied permutations of competing interests that are inevitably implicated by such new technology.”¹⁶

One example of an earlier Congressional compromise designed to encourage maximum use of a new technology for delivery of copyrighted work is the Audio Home Recording Act of 1992.¹⁷ Under the AHRA, manufacturers of “digital audio recording devices” are required to include technology that prevents serial copying.¹⁸ Manufacturers of these devices and of “digital audio recording media” must pay predetermined royalties into a general fund that is, in turn, distributed to holders of certain

¹⁴ *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417, 430–31 (1984). In a footnote, the Court gave examples of technological changes that resulted in Congress passing new copyright rules, including a number of statutory licenses:

Thus, for example, the development and marketing of player pianos and perforated rolls of music, see *White-Smith Music Publishing Co. v. Apollo Co.*, 209 U.S. 1, 28 S.Ct. 319, 52 L.Ed. 655 (1908), preceded the enactment of the Copyright Act in 1909 . . . the development of the technology that made it possible to retransmit television programs by cable or by microwave systems, see *Fortnightly Corp. v. United Artists*, 392 U.S. 390, 88 S.Ct. 2084, 20 L.Ed. 2d 1176 (1968), and *Teleprompter Corp. v. CBS*, 415 U.S. 394, 94 S.Ct. 1129, 39 L.Ed.2d 415 (1974), prompted the enactment of the complex provisions set forth in 17 U.S.C. § 111 (d)(2)(B) and § 111(d)(5). . . .”

¹⁵ *Id.* at n.11. Notably, in both of these instances Congress’ response was the creation of statutory licensing systems rather than merely the creation of new rights.

¹⁶ In *Sony Corp.* the Supreme Court explained that:

The judiciary’s reluctance to expand the protections afforded by the copyright without explicit legislative guidance is a recurring theme. Sound policy, as well as history, supports our consistent deference to Congress when major technological innovations alter the market for copyrighted materials. Congress has the constitutional authority and the institutional ability to accommodate fully the varied permutations of competing interests that are inevitably implicated by such new technology. In a case like this, in which Congress has not plainly marked our course, we must be circumspect in construing the scope of rights created by a legislative enactment which never contemplated such a calculus of interests. In doing so, we are guided by Justice Stewart’s exposition of the correct approach to ambiguities in the law of copyright: “The limited scope of the copyright holder’s statutory monopoly, like the limited copyright duration required by the Constitution, reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts. The immediate effect of our copyright law is to secure a fair return for an ‘author’s’ creative labor. But the ultimate aim is, by the incentive, to stimulate artistic creativity for the general public good. “The sole interest of the United States and the primary object in conferring the monopoly,” this Court has said, “lie in the general benefits derived by the public from the labors of authors.” When technological change has rendered its literal terms ambiguous, the Copyright Act must be construed in light of this basic purpose.”

Id. at 431 (citations omitted, emphasis added).

¹⁶T3Id.

¹⁷ U.S.C. § 1001 et seq.; H.R. Rep. No. 873 (1), 102nd Cong., 2d Sess. 13 (1992).

¹⁸ 17 U.S.C. § 1001(11), 1102.

copyright interests in music.¹⁹ The quid pro quo under the AHRA is that manufacturers and consumers are granted statutory immunity from suits for copyright infringement.²⁰ The AHRA provides for full use of consumer audio tape recording technology, while ensuring a royalty stream for rights holders.

The legislation grew out of litigation filed by music publishers and songwriters in 1990 against Sony Corporation, which had begun marketing DAT recorders. Negotiations aimed at achieving a non-judicial solution soon followed, and ultimately a proposal was presented to Congress as the basis for legislation. The AHRA is the embodiment of the compromise reached among the interested parties.²¹

As explained by the U.S. Copyright Office in its amicus brief in the Napster case: Beginning in the 1980s, consumer electronics firms began to develop tape recorders and other consumer recording devices that employ digital audio recording technology. Unlike traditional analog recording technology, which results in perceptible differences between the source material and the copy, digital recording technology permits consumers to make copies of recorded music that are identical to the original recording. Moreover, a digital copy can itself be copied without any degradation of sound quality, opening the door to so-called 'serial copying'—making multiple generations of copies, each identical to the original source. The capability of digital audio recording technology to produce perfect copies of recorded music made the technology attractive to the consumer electronics industry, which anticipated substantial consumer demand for tape recorders and other recording devices equipped with digital recording technology. However, the same capability was a source of concern to the music industry, which feared that the introduction of digital audio recording technology would lead to a vast expansion of 'home taping' of copyrighted sound recordings and a corresponding loss of sales.²²

Two main benefits flow to the music industry from the AHRA. First, manufacturers of "digital audio recording devices" are required to incorporate into their products technology that prevents serial copying.²³ Second, manufacturers of "digital audio recording devices" and "digital audio recording media" must pay predetermined royalties into a general fund to be distributed to copyright holders.²⁴ The quid pro quo under the Act is that manufacturers and consumers are granted statutory immunity from suits for copyright infringement, and consumers are granted immunity for the "noncommercial use" of digital audio recording technology.²⁵

The AHRA does not create a statutory license, but it achieves a parallel outcome. The interests of copyright holders are served through a system of royalty payments, and the public interest is served by giving consumers the greater access to delivery of protected work that the new technology has enabled. Under the statutory scheme, there is competition in the production of players and tapes by means of which consumers can customize their music listening. Each copyholder is assured of royalties from distribution of the music delivery service—the sales of tape players and blank tapes. Copyholders cannot, however, thwart the delivery process.

In addressing different new delivery services, Congress has adopted varying solutions. In these cases, the marketplace did not provide a complete answer, and Congress acted to establish a government sponsored or facilitated licensing or royalty scheme, or to foster development of the new delivery service in some other way.

In 1909, in recognizing for the first time the right of a copyright owner to authorize mechanical productions of music, such as piano rolls, Congress also acted to prevent creation of a threatened monopoly by a piano roll firm that had entered into exclusive agreements with a number of leading music companies.²⁶ The 1909 statute provides that if the copyright holder has allowed mechanical reproductions. Payment of royalties is required. The statutory procedures required by the license provision are fairly time-consuming and burdensome, so most mechanical licenses are now negotiated privately and directly between the rights holder and the licensees. While these agreements often do not conform exactly to the statutory provisions, the stat-

¹⁹ *Id.* at §§ 1003–07.

²⁰ See 17 U.S.C. § 1008.

²¹ See generally H.R. Rep. No. 873(1), 102nd Cong., 2d Sess. 11–13 (1992) ("House Report"), reprinted in, 1992 U.S. Code Cong. & Admin. News (U.S.C.C.A.N.) 3581–3583; S. Rep. No. 294, 102nd Cong., 2d Sess. 30–45 (1992) ("Senate Report").

²² Brief for the United States as Amicus Curiae, at 5, *A&M Records, Inc. v. Napster* (9th Cir. Mar. 21, 2001), available at <http://www.loc.gov/copyright/docs/napsteramicus.html> (Nos. 00–16401 & 00–16403).

²³ 17 U.S.C. § 1001(11), 1102.

²⁴ 17 U.S.C. at §§ 1003–07.

²⁵ 17 U.S.C. § 1008.

²⁶ 17 U.S.C. § 1 *et seq.*, and as amended.

ute generally provides an outline for the negotiated license and the statutory rate imposes an upper limit on fees that copyright holders are able to charge.²⁷

There are many other examples of legislation designed to solve licensing issues arising from a new form of delivery. For over a decade, jukebox operators had a statutory license for the songs their machines played. Earlier, jukebox operators had enjoyed immunity from infringement claims, in part as a result of an early court ruling. The 1976 Copyright Act removed this immunity and replaced it with a statutory license and minimum royalty per performance, both of which were administered by the Copyright Office. Congress later amended the statute to replace the statutory license/royalty scheme with a requirement that the copyright holders and jukebox operators negotiate a private license in good faith, under the oversight of the Copyright Office.²⁸

Also in 1976, Congress enacted a statutory license for cable services that retransmit broadcast television signals. This legislation was an effort to forge a compromise between copyright owners of television programming and operators of cable companies. Beginning in the 1950s, cable companies picked up transmission signals from broadcasters and retransmitted them, initially to local homes and later, with improved technology, to distant locations. This practice undermined the exclusive agreements between broadcasters and copyright holders, arguably to the detriment of the latter. In two cases, nonetheless, the Supreme Court refused to find that the cable companies were infringing upon the copyright holders' rights.²⁹ Congress responded with a compromise embodied in the 1976 Copyright Act's cable license provision. Congress acknowledged the copyright owners' interests in their broadcasts and determined that the cable companies should pay royalties for their use.³⁰ In addition, Congress determined that transactions costs would be onerous if the cable companies were required to negotiate separately with each rights holder. Congress resolved both issues by means of a statutory license, found in section 111 of the 1976 Copyright Act.³¹ As leading authorities on copyright law have explained, one of Congress' initial reasons for implementing the cable compulsory license was to foster the growth of the thennascent cable industry,³² a purpose that has been very effectively accomplished.

In 1988, Congress enacted the Satellite Home Viewer Act ("SVHA") to enable secondary transmissions by satellite carriers of primary transmissions for private home viewing by owners of satellite dishes. The SVHA created a statutory temporary license for this purpose.

Satellite carriers had began to market dishes to home users as the cost of dish technology came down. Home users were able to receive unauthorized signals directly from satellites, avoiding copyright fees. Although the courts did not find that satellite carriers were infringing copyright owners' rights—they were, instead, "passive carriers"—Congress responded by creating a system of statutory licensing. This legislation follows the same rationale as the cable compulsory license: it allows a new delivery technology to grow and supports a new industry.³³ The statutory license extended only to home users who would not have access to programming if they could not use the satellite dish to pick up a signal; serving the interests of these otherwise unserved consumers was a major purpose of the legislation.³⁴

The advent of webcasting services created a series of new copyright issues. Prior to the passage of the Digital Performance Rights in Sounds Recordings Act of 1995 ("DPRSRA") there had been no recognition in the U.S. copyright laws of an exclusive right of public performance for owners of sound recording copyrights. "While composers of music are given the right to publicly perform their work, owners of sound recording copyrights generally are not. Therefore, when a song is played by a radio station—and, until now, when it was played on Internet radio or via webcast—the composer of the song receives a royalty payment from the radio station, while the owners of the actual recording receive nothing."³⁵ The DPRSRA cre-

²⁷ See A. KOHN AND B. KOHN, ON MUSIC LICENSING 656–68 (2nd ed. 1996).

²⁸ Shubha Ghosh, *MP3 v. the Law: How the Internet Could (But Won't) Become Your Personal Jukebox*, GIGALAW.COM (July 2000), at <http://www.gigalaw.com/articles/ghosh-2000-07-p3.htm>.

²⁹ *Fortnightly Corp. v. United Artists Television, Inc.*, 392 U.S. 390 (1968); *Teleprompter Corp. v. CBS*, 415 U.S. 394, 409 (1974).

³⁰ H.R. Rep. No. 1476, 94th Cong., 2d Sess. 89, reprinted in 1976 U.S.C.C.A.N. 5659, 5704.

³¹ 18 U.S.C. § 2318 (1996).

³² See 2 M. B. NIMMER AND D. NIMMER, NIMMER ON COPYRIGHT § 8.18[A1], 8–197 (1994).

³³ H.R. Rep. No. 887(1), 100th Cong., 2nd Sess. 1988, 1988 U.S.C.C.A.N. 5577.

³⁴ See H.R. Rep. No. 887(1), 100th Cong., 2nd Sess. 1988, 1988 U.S.C.C.A.N. 5577.

³⁵ David Wittenstein and M. Lorraine Ford, "The Webcasting Wars" JOURNAL OF INTERNET LAW (Feb. 1999), available at <http://www.gcwf.com/articles/journal/jil-feb99-2.html>.

ated the first limited public performance right in sound recordings.³⁶ It also amended the 1976 Copyright Act to provide a statutory right to perform a sound recording publicly by means of a digital audio transmission.³⁷

All of these statutory schemes fostered the development of new delivery services, all of which have since proved successful in the marketplace. In the early days of many of them, however, there were sharp disputes about whether the new services should be permitted, and claims were made that copyright holders should be empowered to suppress them. It should be remembered that in *Sony*, *supra* n.14, the Supreme Court came within one vote of effectively outlawing video cassette recorders, which in the end have increased the viewing of movies substantially and have generated billions of dollars for the holders of movie copyrights.

4. Congress then enacted the Digital Millennium Copyright Act of 1998, which, among other things, protects the American public's ability to customize delivery of original work, while again protecting the interests of rights holders

Three years ago, Congress recognized that the copyright laws needed amendment if the full potential of the Internet was to be realized. Congress enacted the Digital Millennium Copyright Act ("DMCA ") of 1998 in part to foster the public's ability to obtain protected content over the Internet, when and wherever it wishes. To achieve this end, Congress granted Internet Service Providers some protection from liability for the unauthorized transmission of protected content by means of their services. A Senate Committee summarized the purpose of these provisions:

Copyright laws have struggled through the years to keep pace with emerging technology from the struggle over music played on a player piano roll in the 1900's to the introduction of the VCR in the 1980's. With this constant evolution in technology, the law must adapt in order to make digital networks safe places to disseminate and exploit copyrighted materials. The legislation implementing the treaties, Title I of this bill, provides this protection and creates the legal platform for launching the global digital online marketplace for copyrighted works. It will also make available via the Internet the movies, music, software, and literary works that are the fruit of American creative genius. Title II clarifies the liability faced by service providers to transmit potentially infringing material over their networks. In short, Title II ensures that the efficiency of the Internet will continue to improve and that the variety and quality of services on the Internet will expand.³⁸

In order to protect the ability to customize delivery of content—to maximize its "option value"—the DMCA "provide[d] certainty for copyright owners and Internet service providers with respect to copyright infringement on-line."³⁹

The DMCA contains four distinct safe harbors, which under certain conditions protect Internet Service Providers, including services such as Napster, from liability for copyright infringement.⁴⁰ The centerpiece of three of the safe harbors is a notice and takedown scheme that provides for the Internet Service Provider to block access to or distribution of infringing content upon receiving notice from a copyright holder that access and distribution are unauthorized. Unless the Internet Service Provider has independent knowledge of infringing content on its system (as defined by the statute), it is entitled to rely upon the notice provisions.

With limited exceptions, the DMCA places the duty to police infringement upon the copyright holder. This policy is essential to prevent imposition of private restraints on content by Internet Service Providers, the entities generally least equipped to decide which content should be permitted to flow through the Internet. Placing the responsibility on the copyright holder is also justified because the copyright holder often may not object to the sharing of its copyrighted content online, and indeed may benefit from the wide and inexpensive dissemination of its content to the public over the Internet.

In the peer-to-peer environment, the Internet Service Provider, such as Napster, does not maintain a copy of any content, but only provides the means for sharing the content directly among its users. Napster itself does not upload or download con-

³⁶ 17 U.S.C. § 115 (1996).

³⁷ *Id.* There are limitations on this right. The DPRSRA granted the new license for subscription transmissions only, and exempted regular radio broadcasts and other nonsubscription transmissions. Wittenstein and Ford, *supra* n.35. It also excluded any 'interactive service,' that is, any service that enables a member of the public to receive, on request, any particular sound recording of his or her choice. Such a service must negotiate a voluntary license directly with the rights holder, which is free to refuse a license.

³⁸ S. Rep. 105-190, 105th Cong., 2nd Sess. 1998 at 2. (The Digital Millennium Copyright Act of 1998) (footnotes omitted).

³⁹ *Id.*

⁴⁰ Title 11, § 512.

tent, but rather any sharing of files occurs directly, peer-to-peer, at the user level. The peer-to-peer service provider does not even see the content being shared among its users. The technology provides the Internet Service Provider with only a transitory, real-time, catalogue of file names, written by its users, that can be accessed by anyone logged on to the service at that moment. Napster's real-time catalogue is maintained automatically, without human intervention, and changes from minute-to-minute depending on who is logged on and what files these users have labeled for sharing.

The DMCA expands the public performance right in sound recordings to include digital audio transmissions in webcast services that resemble traditional "terrestrial" radio broadcasts. It also grants a statutory license for the use of sound recordings in connection with Internet services under certain circumstances. As with the DPRSRA, one of the criteria for receiving a statutory license under the DMCA is that the webcasting service be "noninteractive."

5. In enacting each of these statutes described, Congress addressed pricing problems unsolved by the marketplace, including among other problems transactions costs issues and the need to encourage nascent technologies, while at the same time furthering the underlying goals of the copyright laws.

One of the foremost reasons Congress has amended copyright legislation in the ways just described has been to eliminate, or at least diminish, the transactions costs associated with the introduction of new services. Through Napster's technology, for example, millions of consumers now can have access to a service providing a virtually limitless number and variety of songs. But the rights holders number in the thousands, if not the tens of thousands, for they include not only the record companies, which hold the rights to most of the sound recordings, but also the music publishers, which hold the rights to use the underlying words and music. While the majors all have affiliated publishing houses that own substantial catalogues of songs, ownership of publishing rights is substantially less concentrated than ownership of the rights to sound recordings. Individual licensing each time a song is accessed would necessitate a preposterous number of individual transactions. This is exactly the type of problem that statutory licensing can help solve.

Congress has also adopted legislation where necessary to ensure that a newly developing industry will have an opportunity to flourish. Napster and other peer-to-peer technologies are in their infancy, and their full potential for music delivery is not yet known. They certainly hold substantial promise. Absent Congressional intervention, however, the problems currently plaguing development of online music delivery may never be fully resolved. In that event, the growth of digital music delivery services will be stunted if not smothered altogether, and the enormous popular demand for these services will be frustrated. Congressional action is needed to enable this new technology to realize its potential.

Finally, the copyright laws are ultimately intended to serve the interests of the public in the dissemination of original work. All of the statutes described here were intended to foster that goal. In each case, the statutory scheme provided for more distribution rather than less, while preserving the interests of the rights holders.

The list of services for which licenses and royalty payments are regulated or facilitated by the government is long. The manufacturer and the distributor of a phonograph record pay a statutory rate that is set not by the marketplace but by the Licensing Division of the Copyright Office. This office also issues licenses for the secondary transmission of cable signals, for secondary transmissions by satellite carriers of network and superstation signals for home viewing, and for the distribution of digital audio recording devices and media.⁴¹ A similar scheme could solve some of the problems presented today. It would address transactions costs problems and pricing uncertainties. It would encourage further development of the new services, while also protecting the interests of copyright holders.

Technology like Napster's presents a unique opportunity for consumers to participate in what is, essentially, a vast music library containing an incredible variety and number of songs. Peer-to-peer technology puts consumers in charge, since the service's musical content is determined by the tastes of its constituents—there is no filter blocking works that are less "popular" or less "commercial." A service like Napster's, moreover, presents a platform from which artists who are not affiliated with a major label may become successful. Contrast this model with the controlled and limited digital distribution services that the majors have proposed, and it is clear that the public will be the loser if use of technology like Napster's is restricted.

⁴¹United States Copyright Office: A Brief History and Overview, available at www.loc.gov/copyright/docs/crccla.html#4.

6. While protection against piracy is more difficult in the online world, online technology also threatens consumers' ability to enjoy traditional 'fair use' rights and privileges.

Much has been made of the difficulty rights holders face in preventing piracy of protected works in the digital world, where copying is easy and cheap, and produces copies of the same quality as the original. Massive efforts are now underway to develop new protections for copyrighted work, both through software and hardware devices.

The online universe differs in important ways from the old one for consumers as well. In the "old media" universe, purchasers of copyrighted works were able to share, use, and copy for certain personal purposes some or all of the works they had purchased. In a recent examination of the impact of digital technology on the present copyright regime, a distinguished panel of experts concluded:

Fair use and other exceptions to copyright law derive from the fundamental purpose of copyright law and the concomitant balancing of competing interests among stakeholder groups. Although the evolving information infrastructure changes the processes by which fair use and other exceptions to copyright are achieved, it does not challenge the underlying public policy motivations. Thus, fair use and other exceptions to copyright law should continue to play a role in the digital environment.⁴²

In the online universe, it may become possible for providers of copyrighted material to track the delivery of every copy, and possibly to block the types of personal use of copyrighted materials that consumers have always enjoyed. Unless statutory protections are put in place, fair use rights and privileges may not survive in the digital environment. As leading commentators have recognized, consumers' loss of the traditional rights and privileges of fair use would be significant.⁴³ It would constitute a sharp diminution of the benefits consumers receive when they purchase copyrighted work today.

The copyright laws, as authorized by the Copyright Clause in the Constitution,⁴⁴ are intended to foster the creation and distribution of original works. Copyright holders are to be compensated for licenses because awarding compensation encourages them to create and disseminate their work. It is this goal of promoting the enjoyment and distribution of original work that has led to the various statutes described above, as well as to exceptions to the copyright law, such as fair use. Considered pursuit of a balanced copyright regime has served the nation well, fostering continuing creativity over the centuries. The underlying purpose of the nation's copyright regime should guide analysis of the action needed to adapt the nation's copyright regime to today's technology.

7. The current system of copyright protection needs to be adapted to reflect the transformation of the music marketplace, in the same way that Congress has adapted the laws in the past to reflect marketplace changes effected by new technology.

Americans love music. Technology like Napster's offers music in a new form, as a service the consumer can adapt to his needs and tastes. Yet this technology may be suppressed. This is not what the copyright laws were intended to do. Rather, they are designed to accomplish the opposite result—to foster the wider creation and dissemination of original work.

Moreover, technology is rapidly evolving. The music industry's current strategy of trying use the courts to chase down each new service is doomed to failure, although in the process substantial moneys will be spent and the potential for wider delivery of music will be largely unrealized. In the end, a new legal environment will have to be devised.⁴⁵ If it is done sooner rather than later, millions of dollars in litigation expenses will be saved, copyright holders will receive more compensation, and the public will benefit from access to new music delivery services.

The issue for Congress is how to ensure that Internet technology is fully harnessed in the public interest, while the interests of copyright holders are protected. Many times in the past Congress has successfully addressed technological change, each time adapting and amending the copyright laws to best achieve their underlying goals in the changed circumstances that the new technology has created. It now faces the challenge again.

⁴²Committee on Intellectual Property Rights and the Emerging Information Infrastructure, *THE DIGITAL DILEMMA: INTELLECTUAL PROPERTY IN THE INFORMATION AGE* 215 (2000).

⁴³Jeffrey Garten, *Intellectual Property: New Answers to New Problems*, Business Week Online, April 2, 2001.

⁴⁴U.S. Const., art. 1 § 8, cl. 8.

⁴⁵See Hal Varian, *Economic Scene: The Internet Carries Profound Implications for Providers of Information*, New York Times, July 27, 2000.

8. Conclusion: statutory licensing is fair and needed to enable new music services to meet public demand.

Public demand for new digital music delivery services is powerful and growing daily. These services will be difficult to suppress entirely, but without Congressional action they will be tightly restricted. Millions, perhaps billions, of dollars will be spent in the struggle over their future. Market forces will not resolve the problem, just as they have not resolved problems arising from earlier transformational technological developments in the delivery of copyrighted material. The large music companies, with one exception, have chosen to stand together against the new music services, knowing that they can thereby maintain, at least for a time, their control over the distribution of music products and the selection of new talent. While the new services have to negotiate with each major independently, the majors have worked together against the new services, filing a joint lawsuit through their trade association, jointly working on new security technology, and jointly presenting their viewpoint to the public. Through their joint efforts, they have been in a position to observe one another closely and retain confidence that most of them, at least, will remain in the traditional alliance.

In addition, market problems obstruct the continued development of the new music services as they transition to a fee-based structure. High transactions costs associated with individual licensing of each service subscriber and each sharing of a song, as well as pricing uncertainties associated with a wholly new technology, will make survival difficult for the new services in the absence of a clear and known legal framework. Congressional assistance, along the lines of prior legislation, is thus essential.

I recommend a licensing regime requiring that songs released for public distribution be licensed to the new digital music services as well. Consumers subscribing to these services would pay fees, from which royalty payments would be remitted to rights holders. Such a compromise mirrors multiple prior compromises, in legislation spanning most of the twentieth century. The interests of copyright holders would be fully protected. The interests of consumers would be protected. And the outcome would be consistent with the primary goal of our copyright regime since its inception—the greater production and wider enjoyment of original works.

Statement of National Association of Recording Merchandisers

The topic of this hearing: “Coming Soon to a Digital Device Near You” should have been old news by now. Music retailers and wholesalers have been ready, willing and able to deliver secure online entertainment since 1999. It should have come already, and if it had, frustrated consumers would not have given Napster and other such peer-to-peer music copying services the popularity they enjoy today.

The members of the National Association of Recording Merchandisers (“NARM”) are retailers and distributors of sound recordings. We have played a central role in building the modern music business by partnering with record companies to advertise, merchandise and sell their products, by promoting new artists, by helping fight sound recording piracy, and most of all, by listening to consumers. Each of our retail members strive to be responsive to consumers in terms of price, service, selection, and many other areas that serve to draw customers and distinguish one retailer from another. Retailers bring these competitive urges to the Internet where new competitive elements are introduced, such as ease of site navigation and responsiveness to consumer privacy.

Our members are responsible for the vast majority of all sales of pre-recorded music, and thus are well positioned to provide lawful access to music by downloading or streaming. Over 80% of our retail members have websites, and they are eager to be a part of digital distribution. The question this hearing has been called to ask is important: why isn’t it happening?

The short answer is because record companies, in their zeal to stop Napster-type file sharing, have taken the position that they can trust no one except other copyright owners. They have, therefore, ignored the opportunity which sits right in front of them.

The greatest Napster-related problem retailers have is not the free music on Napster. Retailers have a long history of competing successfully with free goods. We compete with (but welcome) free music over the radio, with libraries, used CDs, and personal-use copying. We recognize that these secondary channels have their place in society, as not everyone is willing or able to pay full price for a new CD. Our

national interest in the widest possible dissemination of creative works is the only basis for Congress to have conferred copyright protection in the first place.

Retailers also compete with the free music coming from the record companies themselves: their record clubs routinely offer “12 CDs for a penny” promotions. With 8 million members per club, that’s over 160 million albums—over 1.6 billion song files given away just to gain market share.

So if we are that good at competing with free music why are we here? We are here because the careful balance copyright law struck as part of the public bargain to encourage creation and dissemination of these works has been upset, and it must be restored as soon as possible.

THE COPYRIGHT MONOPOLY

This balance been upset in several ways, all of which depend on the unique characteristics of the copyright monopolies enjoyed by the major record companies. Copyright law secures to authors or artists, for limited times, certain exclusive rights. For purposes of this hearing, the most important exclusive rights are the right of reproduction, distribution and public performance. When exercised by individual recording artists, each of these rights will encourage broad reproduction, distribution and public performance of their works because such are the avenues by which artists can be compensated, and thereby encouraged to continue their creative endeavors. Because each author depends heavily upon the willingness of others to reproduce and distribute their works, each author has an incentive to offer reasonable terms. For example, music retailers would simply refuse to carry the works of an individual recording artist if that artist demanded an unreasonable price, or imposed unreasonable terms and conditions on how the sound recording could be merchandised or sold. However, when artists assign these rights to corporations that have amassed multi-billion dollar collections of these rights, so that just 5 corporations control 80% percent of all of the sound recordings in the world, the ability of retailers to resist unreasonable terms is greatly diminished. No retailer can refuse to carry Destiny’s Child, Yo Yo Ma or Ricky Martin for long—even if Sony Music embeds them with advertising and links to its own online store.

Until recently, record companies could not control the distribution of copies of their sound recordings once title passed to another. Retailers and consumers were free to sell, lend or even give away lawfully made copies. Today, copyright owners have the power to make a sound recording “time out” after a certain number of plays or after a certain amount of time, the power to prevent a sound recording from playing on one device if it was first played on another, the power to make inoperable a sound recording received by gift, unless the person receiving it pays for it again. In short, thanks to digital technology, copyright owners today enjoy such a high level of control over their works that they hardly need copyright law at all.

NARM contends, however, that copyright law never permitted such a high level of control because it was against the national interest to confer it. Doctrines of “fair use” and “first sale,” which have been codified into law should not be done away with unilaterally through technology. Rather, they should be viewed as the embodiment of important legal principles intended to protect the public welfare and further the national interest.

The following are the matters we consider to be of greatest concern:

ACCESS

Every retailer need not stock every sound recording, but because the five major record companies account for over 85% of all sound recordings, every retailer must at least offer some sound recordings from every major record company or go out of business. In the past, record companies needed access to virtually every retailer, since 90% of all sound recordings are sold through retailers. The digital future will turn bleak, however, if record companies can control who will get to compete in digital delivery, and reserve this market for themselves. Thus far, record companies have shown the most interest in cross-licensing digital rights to each other, or to companies they control or in which they have invested. They have withheld rights from retailers who are perfectly capable of offering secure, compensated digital downloads, but who they no longer see as partners, but as competitors. We estimate that over 99% of the repertoire owned by copyright holders today remains off limits to legitimate retailers who are trying to compete with peer-to-peer file sharing.

CONSUMER PRIVACY

Today anyone can walk into a record store, pay with cash, and not have to reveal their identity to the store. If a retailer is too nosy, a consumer can simply take their

business elsewhere. Online, because a credit card and other personal information are required, most retailers have created privacy policies which let consumers know, in advance, what happens to the information the store collects. Of concern to us is that, thanks to digital technology, record companies are routinely engineering ways to learn the identity of the consumer, even without the knowledge or consent of the retailer who delivers the download. The data can be sold or used by the record company to market directly to the retailer's own customer. The retailer's own privacy policy will be meaningless. The consumer will wonder why a particular company with which they do no business seems to know so much about their music tastes.

As Congress debates whether to impose minimum consumer privacy regulations upon online merchants, one thing should be non-negotiable: No online merchant should be forced to give up its customers to its suppliers. There is no question that secure digital distribution can prevent piracy without destroying privacy. There is absolutely no reason to allow copyright owners to leverage their copyrights into data mining.

ANTITRUST CONCERNS: VERTICAL RESTRAINTS

Never before have we seen the kinds of vertical restraints on music retailers that are today being thrust upon them by copyright owners. Retailers are being asked to sign license agreements that would effectively extend the copyright monopoly to every aspect of the retail channel. One popular approach, referred to as "agent retailing," allows the retailer to offer the record company's music for consumer download, but the record company—not the retailer—sets the price, determines the warranty, dictates the replacement policy for defective downloads, selects which sound recordings will be offered, specifies how the download will be marketed and advertised, and even determines what it will look like on the retailer's web page. Such models raise serious antitrust concern because the retail level of distribution is the only place where true competition for copyrighted materials takes place.

ANTITRUST CONCERNS: HORIZONTAL RESTRAINTS

After efforts to operate retail stores offering their own products exclusively failed, the record companies learned what retailers have known all along: Consumers do not go shopping by record label, but by artist and genre. The music business is not like selling batteries. You can't sell Ricky Nelson to someone who wants Ricky Martin.

Since they could not compete with retailers individually, record companies are increasingly operating in concert, setting up joint ventures among themselves and seeking cross-licenses with each other—to the exclusion of competitors. The likely framework for such ventures can be predicted by taking a look at record club licenses. The two existing record clubs are owned and operated by the major record companies, who crosslicense to each other the right to make each other's records. The licenses are on extremely favorable terms, and penalize artists by treating a large percentage of the licensed copies as "promotional" copies. The \$2.50 licensed copy looks and sounds just like the \$12.50 copy sold to the retailer because it is manufactured in the same factory using the same masters. The only significant difference is that by selling a "license" to reproduce, record companies hope to avoid their obligation under the Robinson-Patman Act to not discriminate in their "sales" of like products to similarly situated retailers.

Today, in the online world, a similar web of interrelationships among the major record companies is being spun which guarantees that no retailer can do business online without competing with an entity jointly owned and controlled by the major record companies. Consider the following: Bertelsman owns CDNow, which has strategic relationships with Sony and Time Warner. Sony and Time Warner are in negotiations to cross license films for digital distribution. Sony has also announced a joint venture with UMVD for a music subscription service called Duet. AOL Time Warner, EMI, BMG all own a piece of MusicNet. Bertelsman and UMVD have a joint venture site called "Get Music". All five major music companies became major shareholders in ArtistDirect. The major home video companies are working together on video-on-demand projects like MovieFly.

COPYRIGHT LAW: THE RIGHT TO ADVERTISE

It has long been understood that retailers of copyrighted goods enjoy the right to reasonably copy portions of the works, display them, and publicly perform them, where the purpose is to promote the sale of the works in question. Notwithstanding the copyright owner's exclusive right to publicly display a work, there is no question that booksellers can publicly display the books and magazines offered for sale. Just

as the bookseller may allow patrons to leaf through and read books in the store without purchasing them, so too may a music retailer allow patrons to listen to the music in the store. Just as the bookseller may post a sample of a book's text on the Internet, so, too, may a retailer post a sound clip.

Today, all of that is changing. Our members are reporting efforts by copyright owners to prohibit these forms of advertising without a license. The only effective way for retailers to advertise even pre-recorded sound recordings over the Internet, for physical distribution, is to post an image of the artwork and offer a 30-second or so sound clip as a sample. BMI has taken the novel position that a 30-second sound clip, considered the industry norm within the bounds of fair and sensible use, is illegal absent authorization from the copyright owner. Some record companies are demanding that retailers get their permission even to post the graphics of the CD itself. There cannot possibly be any diminution in value to the copyright owner when retailers promote the lawful sales of the copyright owner's own works. The sole purpose for this seemingly irrational behavior appears to be to gain greater control over distribution. Indeed, at least one record company has offered to license these uses at virtually no cost, yet requiring a written acknowledgment that a license is required, and reserving for itself the right to withhold authorization to show graphics or offer 30-second samples of any songs it chooses. Absolute and total control over distribution appears to be the sole objective.

COPYRIGHT LAW: PRESERVATION OF FIRST SALE DOCTRINE

Such total control over distribution is something Congress has historically insisted must never fall into the hands of copyright owners, because "the policy favoring a copyright monopoly for authors gives way to the policy opposing restraints of trade and restraints on alienation." M. Nimmer, D. Nimmer, Nimmer on Copyright, § 8.12[A]. Congress has provided that notwithstanding the distribution right, the owner of a lawfully made copy or phonorecord is entitled, without the consent of the copyright owner, to sell or otherwise transfer title or possession of that copy. 17 U.S.C. § 109(a).

Initially, copyright owners resisted the notion that Section 109(a) applied to digital works. They eventually acknowledged that the first sale doctrine continues to apply in the digital world,¹ but now add the caveat "in the absence of licensing or technological restrictions to the contrary."² In other words, this federal right will exist in the digital world only as long as they permit it. NARM believes that it is preposterous to contend that a federal right as important as the first sale doctrine, established first by the courts and later codified by Congress, can disappear at the whim of the copyright owner either by use of licensing restrictions or a line or two of computer code. Yet, that is exactly what they intend to do: nullify a federal statutory right. Sony has decreed that anyone who purchases *The Writing's On the Wall*, a CD by Destiny's Child, installs it in their computer's CD-ROM drive and fails to return it to Sony within seven days after buying it from a record store, has lost their federal right to sell it or otherwise transfer title.³

COPYRIGHT LAW: SELLING WHAT YOU DON'T OWN

At bottom, technology is allowing copyright owners to enforce "licenses" of rights they do not own, and to use rights they do own as leverage to require members of the public to give up their statutory rights.

We have already heard one recording industry speaker talk about a future in which a consumer can select from a number of choices, and "maybe just choose to buy a license to listen to the music." On its face, such a statement may sound like consumers would be given more choices, but in reality, choice is being taken away. Copyright owners have never had the exclusive right to listen to music, and therefore have no right to sell licenses to listen. For example:

The reproduction right: A copyright owner may license the right of reproduction, but it is an abuse of that right to demand payment in the form of consumer data, to license it discriminatorily so as to insure that some retailers fail while others

¹ *Report to Congress: Study Examining 17 U. S. C. Sections 109 and 117 Pursuant to Section 104 of the Digital Millennium Copyright Act*, U.S. Department of Commerce, National Telecommunications and Information Administration, March 2001, Part IV.

² *Id.*, n. 101.

³ The Sony Music Entertainment License Agreement is contained in the readme.txt file that accompanies the music files on the same CD. An excerpt showing the pertinent language is attached to this Statement. Another company's license agreement used for a download is also attached.

succeed, or to cross-license it among the other copyright monopoly holders to the exclusion of retail competitors.

The distribution right: A copyright owner may license another person to distribute copies and phonorecords of its works, but it is an abuse of that right to require that those who obtain lawful ownership in the chain of distribution give up their statutory right under 17 U.S.C. § 109(a) to sell or otherwise transfer title or possession without the copyright owner's consent, or to license the distribution subject to technological restrictions that prevent the owners from exercising those rights.

The right of public performance: For a copyright owner to sell someone permission to listen to the copyright owner's music is like selling a license to read a book separate from the book itself. Even when a copyright owner licenses to someone the exclusive right of public performance, the copyright owner has no right to dictate who can watch the performance. There is no exclusive right of *private* performance of a work, much less an exclusive right to listen to a private performance.

Congress should stand firmly in favor of confining exploitation of copyrights strictly to the those rights conferred by Congress, and subject to the limitations imposed by Congress. It must not allow copyright owners to use technology and contracts of adhesion to limit consumer and retailer rights, nor to simply take control where Congress has clearly denied it.

Retailers do not need the permission of record companies to sell pre-recorded sound recordings. They have the right to set their own prices, choose their customers, play the sound recordings in the store and stream short samples online, all without the authorization of the copyrights owners. Those rules should apply equally in the online world, but instead, copyright owners are licensing what they don't own, and enforcing those licenses by use of technological restrictions. If they are unwilling to abide by the Copyright Act in letter and spirit, it may be up to Congress or the courts to tell them, like the Fourth Circuit did in *Lasercomb America, Inc. v. Reynolds*, 911 F.2d 970 (4th Cir. 1990), that they will lose their power to enforce their copyrights until they stop leveraging their copyright power into areas beyond the limits set by Congress.

CONCLUSION

Today, we are asking that the first sale doctrine be respected for digital downloads just as it is for pre-recorded copies; that all retailers be allowed equal access to retail each record company's music library; that each retailer be allowed to compete on price, service, and privacy; that no retailer be required to get the copyright owner's permission to advertise the products they sell; and that no consumer be required to become part of the copyright owner's data mine as part of the price for listening to music. If our demands to the copyright community for freedom to compete, for freedom to advertise what we sell, and for freedom to protect our customers' privacy are not met, tomorrow we may be asking Congress for something more: We may be asking for antitrust investigations of these unfair trade practices, and for fair but compulsory licenses to make secure downloads and digital transmissions.

NARM's retail members are confident that, given half a chance, they could offer the public a superior product and service to that offered by free peer-to-peer file copying. Although some record companies are beginning to respond to the concerns of retailers, the record companies, as a whole, are giving them no chance at all.

NARM is the principal trade association for retailers and distributors of sound recordings. Its approximately 1,000 members are engaged in all aspects of music distribution to the consumer. For further information, please contact Pamela Horovitz, NARM's President, at (856) 596-2221.

SONY MUSIC ENTERTAINMENT INC. LICENSE AGREEMENT

This legal agreement between you as end user and Sony Music Entertainment Inc. concerns this product, hereafter referred to as Software. By using and installing this disc, you agree to be bound by the terms of this agreement. If you do not agree with this licensing agreement, please return the CD in its original packaging with register receipt within 7 days from time of purchase to: Sony Music Entertainment Inc., Radio City Station, P.O. Box 844, New York, NY 10101-0844, for a full refund.

1. LICENSE; COPYRIGHT; RESTRICTIONS.

You may install and use your copy of the Software on a single computer. You may not network the Software or otherwise use or install it on more than one computer or terminal at the same time. The Software (including any images, text, photographs, animations, video, audio, and music) is owned by Sony Music Entertainment Inc. or its suppliers and is protected by United States copyright laws and its international treaty provisions. You may not rent, distribute, transfer or lease the Software. You may not reverse engineer, disassemble, decompile or translate the Software.

SCHEDULE A—Business Rules

In the absence of contrary Business Rules provided with a Content offer, the following default Business Rules shall apply to all UMG Content:

1. You may only download Content to a portable device that is (i) compatible with the InterTrust Technologies Corp. digital rights management system, (ii) compliant with the requirements of the Secure Digital Music Initiative (SDMI), and (iii) compliant with UMG's content security requirements.

2. You may not copy or "burn" Content onto CDs, DVDs, flash memory, or other storage devices (other than the hard drive of the computer upon which you installed the Software). In the future, UMG may permit you to make these types of copies of UMG Content to certain SDMI-compliant storage media.

3. You may not transfer your rights to use any particular copy of Content to another. For example, you may not transfer your rights to another at death, in divorce, or in bankruptcy. This is not an exclusive listing; it is only a set of examples. Notwithstanding this Business Rule, you may email a Content Reference to another consumer to enable that consumer to purchase his or her own rights in Content.

4. You may not transfer or copy Content (with the rights you have purchased) to another computer, even if both computers are owned by you. You will be able to copy locked Content to another computer, whether that computer is owned by you or not, but the rights you have purchased to use that Content will not travel with the copy. In the future, UMG may permit you to make these types of transfer of UMG Content along with the rights you have purchased.

5. You may not print the photographic images, lyrics, and other non-music elements that are distributed with Content.

6. When you purchase the right to unlimited use of Content, the use rights associated with that Content terminate upon your death.

7. There is currently no free UMG Content. All rights must be purchased. The only exception to this rule is that 30 second audio clips may sometimes be made available by UMG without charge.

8. UMG may revoke your rights to use Content pursuant to the terms of the foregoing License Agreement; in the case of a violation by you of the License Agreement; in cases of suspected fraud by you or another; in cases of a suspected security breach by you or another; in order to forestall or remedy any legal exposure to UMG or its affiliated companies; and in other situations in which UMG in its judgment believes it advisable to do so in order to protect Content, the Software, and/or UMG and its affiliated companies.

Statement of NWEZ.NET, Gloria Hylton, President

Thank you for the opportunity to address this committee. I appreciate the chance to speak on behalf of the small independent webcaster. I feel our interests have not been represented in prior hearings on these issues of vital importance to our survival. I am not a lawyer and apologize in advance for any lapse in protocol in the following document and ask your indulgence and understanding as I try to enumerate our concerns and arguments.

Here is an outline of the areas to be addressed in the body of this statement:

I. An overall concern with the DMCA

The inherent problems of allowing the RIAA and vested interests to frame and dominate copyright regulations on the Internet including discussion regarding:

(1) 'Individually' negotiated licenses; 'Retroactive' royalty fees; Qualifications for a compulsory license; The illusion of 'non-interactivity'; Indirectly subsidizing engrained industries; Legislating technological discrimination; Determining appro-

ropriate sound recording copyright performance royalties (hereinafter referred to as sr royalties); The collection and distribution of sr royalties; DiMA and the DMCA;

II. A brief historical overview of traditional business practices within the music industry and how this relates to the current state of affairs with copyright licensing on the Internet Background on NWEZ.NET and our mission/vision

SUMMARY

I. In 1998, with the passage of the DMCA, laws were enacted with serious ramifications for the emergent online entertainment marketplace. While I have no doubt Congress intended these laws “. . . to promote the progress of science and useful arts. . .” and that there are provisions within the act that do so, I argue that many provisions within this act have accomplished the exact opposite. I further argue that the provisions dealing with sound recording performance rights lobbied for by the RIAA were drafted so that the major labels could position themselves in a manner that would insure their continued control of the music industry and thwart companies posing any threat to that status. I believe the RIAA arguments offered to members of Congress in the DMCA hearings were intentionally misleading in much the same way the arguments for the now overturned ‘work for hire’ amendment were misleading. I believe the ensuing actions taken by the labels in the digital arena have spoken much louder than their 1998 rhetoric.

II. Areas in the DMCA or resultant of the DMCA that we believe should be addressed in regards to webcasting:

(1) First and foremost, if webcasters are forced to pay sr royalties for the first time in the history of U.S. broadcasting, *all webcasters should be assessed these rates on a fair and equitable basis. The RIAA should not be granted an anti trust exemption to negotiate ‘individual’ webcasting licenses.* While it is true that a blanket license to webcast is needed, the RIAA should not be able to grant these licenses on an ‘individual’ basis. Standard blanket license guidelines with provisions for varying business models should be established and enacted. The current performance rights organizations ASCAP, BMI and SESAC have such licenses in place for songwriter/publisher copyrights. These organizations have guidelines that are out in the open for anyone to examine, offering some insurance against preferential and biased licensing. On the other hand, the RIAA has been negotiating webcasting licenses in private, without public disclosure of the terms being reached. This arrangement has allowed a great deal of power to be wielded by the labels in the nascent webcasting field. Webcasters looking to secure investment capitol are desperate for a figure to place in their ‘RIAA Royalty’ column. This puts them at a distinct disadvantage when negotiating deals. Most disturbing under the current arrangement, *the labels can cut more favorable deals with companies they have equity stakes in (essentially making preferential deals with themselves) to the detriment of an open, fair and competitive marketplace. They can also negotiate to obtain equity stakes and/or promotional considerations from webcasters in exchange for licensing. The RIAA, for obtaining such advantages can in turn offer said webcasters lower up front royalty rates, excuse payment of upcoming ‘retroactive’ royalty fees, and/or offer lenient application of the rules governing compulsory licensing. The labels can refuse to grant individual’ licenses to those companies whose business models they dislike, creating a scenario whereby webcasters choosing not to ‘play ball’ with the RIAA will find themselves competing against webcasters who have obtained unfair advantage in exchange for concessions they’ve yielded to the labels—concessions which may never be openly disclosed.* You can see the inherent latitude for corruption within this arrangement. It is true that once the CARP panel sets general sr royalty rates (which coincidentally keeps getting pushed back) that all webcasters not making prior ‘individual’ deals with the RIAA will be assessed these rates equally; however, we have no guarantee that there will be latitude within these rates for varying business models. I approached the copyright office with a desire to participate in the CARP proceedings and represent the interests of small, independent webcasters. I was informed that registering to participate in the CARP proceedings would make me financially responsible for paying the arbitrators a ‘yet to be determined and they could give me no idea of how much it would be’ fee. Not having unlimited financial resources at my disposal I decided not to participate. I find it disheartening that in a government founded to represent ‘the people’ *the only people whose voices will be represented at the upcoming CARP proceeding will be those who can afford an undetermined entrance fee to be ‘in the room’.* This naturally doesn’t instill confidence in the fairness of the upcoming proceeding. Especially given such market deals’ being offered for consideration by the RIAA as the one negotiated with the now defunct Soundbreak.com. Lisa Crane, the CEO who negotiated Soundbreak’s licensing agreement was let go following the deal. She subsequently became a paid

consultant, with the RIAA on her roster of clients. This is disconcerting to webcasters in the same way it was disconcerting to NARAS when Mitch Glazier, who authored the 'work for hire' amendment was later hired by the RIAA. The inference is that the 'market rate deals' being presented to the CARP panel are dubious at best. Nonetheless, *once the CARP sets the standard rates for webcasters not negotiating individual deals, these webcasters will be responsible for these fees retroactively back to the passage of the DMCA in 1998. This is particularly devastating to a nascent industry struggling to find profitability.* I believe it is a deliberate attempt by the labels to control the entire webcasting industry. Perhaps this is what prompted Mark Cuban, founder of Broadcast.com, to sell his company and state on kurthanson.com, "What's the best business in the webcasting industry? Prepackaged bankruptcies to avoid the RIAA fees!" Since 'individual' webcasting deals are already in place, in lieu of adopting this suggestion I offer the following redress to this grossly prejudicial and industry crippling situation:

SR Royalties should be applied from the time they're determined, not assessed retroactively. These royalties should begin when they are determined and be applied equally to all webcasting companies. *Otherwise, those webcasters making 'individual' deals may be excused from the 'retroactive' charges, while those not making deals are forced to pay them.* This effectively puts webcasters who do not deal with the major labels or whose business models are unappealing to the major labels out of business or at a distinct disadvantage. *This goes against the very premise of our 'free market' economy and gives the major labels mandated monopoly control over the entire webcasting industry.* Arbitron statistics coming out of the NAB Convention show that households with broadband split their entertainment time equally between television, traditional radio, and the Internet. They also show that these households are equally likely to tune into a webcast-only station as a traditional radio station being rebroadcast on the Internet. They derive the conclusion *that Internet radio will soon be able to sell advertising in the same way traditional radio does.* Many players in this marketplace with oversized egos, budgets and spending patterns have come and gone. Those of us that have survived have done so through hard work and frugal spending. Do not punish us when the promise of profitability is only now on the horizon. *It would be unfortunate if those building this business were forced out of business and webcasting were only viable for the huge corporate interests currently controlling the traditional music industry (and their 'partners').*

The above commentary doesn't address the *inherent problems of qualifying for a compulsory license to begin with.* The variety of hoops a webcaster is required to jump through to be compliant for a compulsory license is arbitrary and unreasonable. Anyone conversant with webcasting realizes these regulations are onerous and a webcaster will most likely be unable to abide by these regulations in some way. This once again gives the RIAA negotiating power in the webcasting realm, as they are unlikely to monitor those webcasters making deals with them as closely as they will others. *The threat of selective enforcement of these regulations is real. An argument could even be made that these regulations were intentionally drafted in a manner that makes compliance next to impossible.* The most serious of these restrictions involves the limitation on the number of 'ephemeral copies' a webcaster can make to conduct webcasting operations. These restrictions are in stark contrast to land-based broadcasters, who are allowed to make as many ephemeral (digital!) copies as necessary to conduct normal broadcasting operations. I have a difficult time understanding the reasoning behind limiting a webcasters ability to do the same. These are copies strictly used by the webcaster themselves and are arguably 'fair use'. Webcasters compliant for compulsory licenses are subject to many seemingly impossible regulations. For example, compliant webcasters are prevented under the 'sound recording performance complement' from playing any four songs from a boxed set in a three-hour period. Does this mean every webcaster is responsible for knowing every combination of songs on every box set ever made and that their show hosts are responsible for memorizing these song combinations so they don't play them during any three-hour time span? Compliant webcasters cannot announce song titles prior to playing them, although their counterparts in traditional broadcasting regularly do so. Compliant webcasters are required to give the song title/artist name/cd title while the song is being played, although their counterparts in traditional broadcasting are not. *Compliant webcasters cannot even engage in the time-honored tradition of taking 'requests' from their listeners. To do so would be considered 'interactive'.* Traditional broadcasters are not expected to abide by the same rules of operations as 'compliant' webcasters. *This not only favors the old technology for streaming music over the new technology for streaming music, but also completely ignores the true potential of the webcasting experience—where fans can interact directly with show hosts and even artists. To be compliant, a webcaster must essentially ignore those attributes of interaction inherent to the Internet that*

would attract and hold an audience and make his business successful. One could argue this is the intent of compulsory regulations to begin with, especially given that labels are gaining equity stakes in many webcasting companies which they conveniently then write 'individual' licensing agreements for. *(The fact that labels are able to obtain equity interest in webcasting companies at all is disconcerting to a layman like myself and smacks of conflict of interest—given the labels also license these entities and have a vested interest in what content is disseminated through them).*

The stranglehold definition of 'interactive' being applied by the RIAA to webcasting not only unfairly discriminates against new technology but also completely disregards the reality of the digital realm. At this point in time if you tune into a webcasting station like NWEZ.NET you will find that your 'stream' cuts out periodically due to 'buffering' due to 'net congestion'. It is therefore highly unlikely anyone would attempt to capture digital copies of current webcasts, no matter how 'interactive' or 'non-interactive' they were. If they did they would get some pretty awful copies. Copies made from your traditional broadcasting stations would be much better quality and easier to obtain. Having said that, however, I recognize that *the coming prevalence of broadband connections combined with the continual advent of tivo-like consumer devices will eventually make it so any Internet programming anywhere will face potential capture and copy.* This will be true for both interactive and non-interactive webcasts. Non-interactive webcasts could easily be saved in their entirety and later edited to get rid of unwanted material, essentially allowing the consumer to make them 'interactive'. *Given this certainty it is my belief that all blanket webcasting licenses should be considered to be 'interactive.'* No matter what you want to believe, the reality is that for all intents and purposes all broadcasts have the potential to be stolen, even in the analog world. HBO has no way of knowing if they are streaming a 'performance' or a 'copy' of a movie into a home. Whether they stream a performance or a copy is totally dependent on how the person receiving it behaves. If they hit record on their VCR then HBO just streamed them a copy even though they intended to stream them a performance. In much the same manner you can't legislate away drug use or prostitution, a thief will always find a way to steal if that's what they truly want to do.

It's interesting to note, however, that just like the videocassette recorder brought about new revenue and actually benefited the industry that feared and fought it, the Internet has actually increased consumer demand and interest in music. In a related aside, Cd Baby, the largest retailer of unsigned artist cds on the Internet, reports that *1 in 20 purchasers at Cd Baby buys a cd after hearing the band on Napster.* This information is gathered in the section of the order form asking why the customer is buying the cd. This statistic surprised me because I would have imagined most Napster users were only interested in known major label acts. It seems to support the theory that many people use Napster more as a listening' and 'pre-screening' device.

If file sharing can be argued to potentially benefit recording artists it is difficult to imagine webcasting, interactive or not, hurting them. On the contrary, *webcasting, like traditional broadcasting, offers recording artists and copyright holders beneficial promotional opportunities.* Labels have traditionally paid to insure their products are heard over the airwaves. *Cyberwaves are the airwaves of the future. We are all familiar with the previous 'payola' scandals in the music industry.* It can be argued that 'payola' still exists in the mainstream marketplace but has been officially removed by the advent of the independent promoter' who is paid to solicit label offerings to broadcasters and in turn pays broadcasters to secure spins.

Why should webcasters now pay labels to offer them these same promotional opportunities? I believe the labels recognized the Internet as a way to continue to control what musical content is promoted, but without paying a middleman. In fact, now the promotional channels will have to pay them! At NWEZ.NET we frequently get grateful e-mails from unsigned artists receiving 'cyberplay'. I just received an e-mail from a talented band based in London who sold a cd to a NWEZ.NET listener directed to their website after hearing their song on our station. This is the kind of activity I feel the RIAA fears. Artists currently have the ability to record and manufacture professional sounding product. The Internet offers them the opportunity to sell that product to a global market. Distributors like Cd Baby can ship and warehouse product. The missing link is promotion.

If the Internet offers promotional opportunities to all artists via webcasting stations, without regard to their affiliation with a major label, this threatens the long-term existence of intermediaries like record labels. The ability of fans to directly contact recording artists and/or buy their product without the necessity of that artist going through the major label system is what I believe the industry is trying to avoid. Already we're seeing artists begin to organize via the Internet and reject traditional record label practices. *The Rosenbergs are a wonderful example of this.* This

unsigned power pop band received notoriety for turning down the opportunity to go on farmclub (a major label and Internet cooperative venture) and perform alongside the well-known band The Counting Crows. They took exception to the 23 page, one-sided binding 'potential' record label deal given to them prior to the appearance which gave the label many options to tie up the band if they chose to do so (including laying claim to their website!) The Rosenbergs shared this contract with fellow unsigned artists, warning them about the potential consequences of appearing on the show. Farmclub then changed their appearance stipulations as a result of the following publicity, to the benefit of all future unsigned artists appearing on the show. The Rosenbergs went on to sign a groundbreaking new record deal with a small UK-based label, Discipline Global Mobile, where *they retain the rights to their sound recording copyrights and enjoy a band/label arrangement that is a fair partnership*. Another example of an Internet success story is *Emily Richards, who has made a good name for herself via MP3.Com*. Richards had a more extensive tour last summer as an unsigned artist than *No Doubt* did on their first major label tour. MP3.Com is a prime example of an Internet company offering many advantages to artists previously excluded by the mainstream music industry. The labels have aggressively pursued lawsuits against MP3.Com and other innovative Internet music services. *By garnering equity stakes in webcasting companies and making it prohibitive for companies not licensed by them to operate, the record labels are insuring their long-term existence and continued dominance in the music industry*. Accordingly, *copyright legislation that allows the established industry giants to bully their way to dominance in the new marketplace indirectly subsidizes those corporate interests and perpetuates their essentially monopolistic powers to the detriment of Internet entrepreneurs, recording artists, and the public at large*.

Along similar lines, *it is blatantly unfair to assess sr copyrights to webcasters and not to traditional broadcasters. Why should the new medium for streaming music pay these royalties when the established medium for streaming music never has and is not slated to do so in the future?* Simply because the NAB is a more powerful lobbying organization than the RIAA? *This inequity illustrates the unfortunate influence huge corporations and their 'collective' lobbying groups possess in affecting public policy*. Sr royalties only apply to webcasters. Webcasters are essentially penalized for enabling the 'progress of the arts through the new science of Internet technology', or, in effect, embodying the very intent of copyright. This, to spite the fact traditional broadcasters operate at a healthy profit and most webcasters have yet to break even. *This gives traditional broadcasters yet another advantage over webcasters and allows them once again to play by different rules, essentially legalizing technological discrimination*. I was happy to see the recent copyright office decision requiring traditional broadcasters to pay sr royalties when rebroadcasting their signals over the Internet. Naturally, if these fees are to be assessed in the digital realm at all they should be assessed to every webcaster, whether or not that webcaster also has a land-based station.

Also along similar lines, *sr royalty rates should be equitable to the royalty rates for songwriting/publishing*. Rumor has it the RIAA will try to obtain 3–10 times the rate collected for songwriting/publishing royalties for sr royalties. *Why should the recording of a song be worth more than the creation of that song in royalty fees?* Simply because the owners of the vast majority of sound recording copyrights have a large lobbying organization? The argument that labels invest a lot of money into recordings doesn't follow. Many new bands are signed on the basis of cds they've already recorded. My friend Bobby Gaylor was picked up by Atlantic after recording his own cd. Atlantic did not rerecord the cd but went with the recording 'as is'. I guarantee you that unsigned artists aren't spending hundreds of thousands of dollars on cd production and many are ending up with product as radio ready as major label artists. I state this to illustrate that *recording a professional quality cd doesn't have to cost hundreds of thousands of dollars*.

Another point of contention is *who will collect and distribute these new digital royalties*. I suggest the major labels should not be allowed to be the sole organization doing so. I would go further and suggest an independent accounting agency be put in charge of collection and *distribution of these royalties to insure fair and open bookkeeping*. Major label artists already complain of improper accounting of their artist royalties and difficulty in attempting to examine record label's books. It would therefore seem appropriate that labels not even be allowed to enter this marketplace. *They have inherent conflicts of interest*. I would also strongly suggest that *the legislated artist cut of the sr royalty be further defined to insure artists receive direct payments in perpetuity*. *Otherwise, following a staged public relations year by the RIAA where artists are paid directly, artists may never see these monies due to the nature of record label recoupable' clauses*.

In another example of improper representation, *DiMA*, the organization meant to represent webcasters at the congressional committee hearing regarding the DMCA amendments, was ill prepared for the hearing at which it spoke. The organization had hastily organized only days prior to the event. While their intentions may have been good, this gave them a distinct disadvantage when arguing these issues with a wellresearched, well-established and extremely powerful lobbying organization, the RIAA. *DiMA* represented only 7 Internet companies at the time of the hearing, none of which were small independent webcasters. *DiMA* represented only 2 large webcasters, one of them being *Broadcast.com*, which had yet to have its IPO. Seth Greenstein, the lawyer speaking on behalf of *DiMA* at the hearing, explained that *DiMA* could not afford the RIAA's threatened litigation should the DMCA amendments not pass. Both webcasters in *DiMA* were looking to attract investors and worried that potential problems with the RIAA might scare them off. I submit that *DiMA* was therefore unable to adequately represent the majority of webcasters at the time they spoke at the hearing and ceded these amendments be added to the DMCA. I was also told off the record (and therefore cannot confirm) by another party involved with the proceedings that the *DiMA* members involved in the hearing all secured certain allowances in exchange for not challenging the DMCA amendments. It is interesting to note that an attorney observing the negotiations taking place between the RIAA and *DiMA* (in regards to the DMCA) commented in a CNET article: "It's a victory for the RIAA that the webcasters were willing to concede that the digital performance right does apply to them. I think the law weighed a little more heavily on the side of the webcasters, but the RIAA leveraged its commercial position to gain the concession by the webcasters."

III. The RIAA leveraged its commercial position to gain the concession by the webcasters at the hearings dealing with the DMCA amendments. It's to be expected. The RIAA continues to leverage their position in the digital marketplace.

The major labels have always operated in a manner meant to control and manipulate the music industry to their advantage and to the detriment of the artists they supposedly represent and the public they supposedly serve. Recently they were found guilty of price fixing cds with their 'minimum advertised pricing' policies with retailers, gouging consumers out of millions of dollars. We have all seen the VH1 'Behind the Music' stories which chronicle the lives of recording artists who have little money to spite selling millions of records. We have read Courtney Love's rundown of major label math, which shows how a recording artist selling over a million records ends up owing their label money. Record label contracts are notoriously one-sided and difficult to break. While the RIAA claims to be representing recording artists, the majority of recording artists do not own their own sound recording copyrights. The RIAA tried to further extend their grasp over these particular copyrights with the 'work for hire' amendment. This amendment was *deceptively described to Congress as a means of protecting artist websites. The DMCA amendments were deceptively described as a means to facilitate webcasting.* The major label rhetoric obviously cannot be trusted. The reasons they offer for the regulations they request are often far removed from their true goals. Major labels have historically dealt in unfair business practices such as 'payola', with ties to organized crime. *I beseech you to treat their arguments with the appropriate skepticism and remember that the RIAA's sole purpose for existence is to manipulate public policy to the advantage of the oligopoly that is the major label system.*

Recently, the RIAA has broken new ground in invading the privacy of our home computers to prosecute copyright offenders like the college student from Oklahoma whose computer was seized for file sharing violations. As a private citizen I request that you not lose sight of the importance of *privacy* issues when the RIAA requests more copyright controls. I also request that you consider the importance of *fair use* to the public good. I further request that you not allow a grasping and greedy industry to reign in the development of exciting technological advances. *There are many rights in the balance of these copyright issues besides those of control.*

IV. NWEZ.NET is a mom and pop webcasting station based in California. We specialize in live shows that go out with both audio and visual streams and include an interactive chatroom. We are proud to offer programming outside the mainstream media box, giving opportunities to unsigned and specialty artists excluded from most traditional airwaves. All the show hosts at NWEZ.NET are allowed to choose their own musical programming. If you'd like more information on our station please visit us at <http://nwez.net> and click on the 'About NWEZ' link.

V. In conclusion, I call upon the sense of justice and fair play of the honorable Senators of the Judiciary Committee and ask you to provide a way for NWEZ.NET and stations like us to survive. Reexamine and revise webcasting provisions lobbied for by the RIAA and provide allowances for the reality of Internet webcasting. Do not allow current unreasonable compulsory licensing restrictions or punitive 'retro-

active' royalty payments to squash the promise of a more open, artist-friendly, and consumer-responsive marketplace. Do not allow the Goliath to slay the Davids. Thank you for your time and consideration.

Statement of Video Software Dealers Association

The Video Software Dealers Association (VSDA) submits this statement for the record of the hearing on online entertainment and copyright law. We wish to make the committee aware of our concerns about business models for online entertainment that could undermine the first sale doctrine of copyright law and the public policies it serves, harm retail competition, and erode consumer privacy.

VIDEO SOFTWARE DEALERS ASSOCIATION

Established in 1981, VSDA is a not-for-profit international trade association for the \$19 billion home entertainment industry. VSDA represents more than 2,000 companies throughout the United States, Canada, and 22 other countries. Membership comprises the full spectrum of video retailers (both independents and large chains). VSDA also includes the home video divisions of all major and independent motion picture studios, video game and multimedia producers, and other related businesses which constitute and support the home video entertainment industry.

COPYRIGHT LAW AND HOME VIDEO

Copyright law, and particularly the first sale doctrine (codified at 17 U.S.C. 109(a)), provides the legal foundation that has facilitated the phenomenal growth of the home video industry over the past two decades. Section 109(a) provides that, notwithstanding a copyright owner's distribution right, the owner of a particular copy or phonorecord lawfully made under U.S. copyright law "is entitled, without the authority of the copyright owner, to sell or otherwise dispose of that copy or phonorecord." The first sale doctrine gives retailers the right to rent and sell videos and video games without restriction by the copyright owner, and benefits society by promoting retail competition and maximizing distribution of copyrighted works.

When videocassette recorders (VCRs) first emerged as a consumer electronics product in the late 1970s, few imagined how ubiquitous they would become in America's homes and how popular watching a prerecorded video of a motion picture would become. For an overwhelming majority of America's 250 million plus consumers, renting and buying prerecorded videocassettes, digital versatile discs (DVDs), and video games is an integral component of their entertainment options. More than 90% of the households in the U.S. own at least one VCR. And although the DVD is a relatively new format, approximately 15 million households already own a DVD player. It is estimated that almost 2.8 billion videotapes and DVDs were rented in 2000. Approximately one-third of all video-equipped households rent a videotape or DVD weekly, while 50% rent at least once a month. More than 60% of video-equipped homes have a video library of some sort. The average videotape library contains 75 titles, while the average DVD collection contains 19 titles. Consumer spending on video rentals in 2000 was a record \$8.25 billion. An additional estimated \$10.8 billion was spent purchasing videotapes and DVDs, with DVDs representing 32% of the total dollars spent.

Although the motion picture studios strenuously resisted the emergence of the VCR and the creation of the video rental industry, even going so far as petitioning Congress to eliminate the first sale doctrine for prerecorded videos of movies, the home video industry today is an enormously profitable enterprise for the motion picture studios. Total revenue to the studios from video sales and rentals totaled \$10.7 billion in 2000. Over the past several years, revenue from home video has accounted for more than half of the studios' gross domestic film revenue.

Video retailing, while experiencing some of the consolidation and slowing of growth of a maturing industry, remains a vibrant enterprise. As of early 2000, there were 20,000 video rental specialty stores in the U.S. These stores included the major public chains such as Blockbuster, Hollywood Video, Movie Gallery, and a significant number of independent retailers. It is estimated that more than 40% of video specialty stores currently are single-store operations. Another 8,000 non-specialists, primarily supermarkets and drugstores, also rent video as a regular part of their business, and numerous other retail outlets sell prerecorded videos.

Thus, the freedom to rent and resell videos guaranteed by the first sale doctrine has provided consumers with access to affordable, quality entertainment that they

can enjoy in their homes, generated a tremendous revenue stream for the copyright owners, and created a thriving industry of primarily small, community-based businesses.

THREATS TO THE FIRST SALE DOCTRINE

The benefits of the first sale doctrine to society, consumers, copyright owners, and video retailers are threatened by some of the trends in online entertainment. Unfortunately, the very same characteristics of digital formats that enable copyright owners to prevent the making of illegal copies and phonorecords can also unintentionally limit or purposefully suppress retail competition and prevent the owners of lawfully made copies from exercising rights Congress and the courts have granted to them.

For example, access control technology can be used to prevent or control lawful use as easily as it can be used to deter copyright infringement. The use of such technological locks on lawful use are the digital equivalent of preventing anyone from reading a book unless they make a payment to the copyright owner every time they wish to do so. In addition, some contracts of adhesion (such as “click-through” end user license agreements) incant that a sale is not a “sale” but a “license” that restricts the purchaser’s ability to use and transfer ownership of the product. In a digital environment, “click here to agree” is a non-negotiable step in an automated transaction, leaving no opportunity to object.

These concerns about the erosion of copyright law in online entertainment are not theoretical. Miramax is currently licensing the reproduction of the movie “Guinevere.” Despite the fact that anyone who downloads the movie is the owner of a lawfully made copy, and enjoys the federal right to transfer title or possession of their legal copy by sale, lease, or gift, the technology employed with the download ensures that the owner must watch the movie within 24 hours of unlocking it, after which the movie is rendered an inaccessible 500 megabytes of code. The person who downloaded it still owns that copy, and still has the right to sell it or give it away, but no one can ever watch it again without paying the copyright owner again for that privilege.

VSDA is opposed to any erosion in the rights provided by the first sale doctrine. We believe these mechanisms are not legitimate uses of technology but rather attempts to use technology to create heretofore unrecognized “rights” and to provide copyright owners’ unprecedented control over the lawful use and distribution of copyrighted works—control Congress has expressly denied to them in the Copyright Act.

Video retailers recognize and support the rights of copyright owners to prevent infringement of copyrighted works. VSDA actively supported the enactment of the Digital Millennium Copyright Act (DMCA) and specifically the anti circumvention provisions in the understanding that these provisions were intended to deter piracy. We have supported the positions of copyright owners in *Napster, Inc. v. A&M Records*, *DVD Copy Control Ass’n, Inc. v. Bunner*, and similar cases. VSDA also actively works with the Motion Picture Association of America to identify individuals that are infringing the copyrighted works of its members. Thus, we do not align ourselves with those whose apparent goal is to make meaningless the legal protections that copyright law provides to prevent piracy of covered works.

At the same time, we cannot support those in the copyright owner community who apparently seek to disable the protections that copyright law provides to legal owners of lawfully made copies of copyrighted works. Copyright owners have taken the position that they are free to make the first sale doctrine inoperative through access control technology and end-user license agreements. Because the first sale doctrine furthers the important public policies of promoting competition and maximizing dissemination of copyrighted works, the rights it confers cannot be extinguished either by unilaterally imposed technological controls or agreement between the parties. To conclude otherwise would make the rights granted by the first sale doctrine merely contingent on the technological prowess or goodwill of copyright owners.

A digital copy authorized by the copyright owner that is delivered by downloading onto a consumer’s computer or portable storage medium (such as a writeable compact disc or DVD) is no different from a digital copy authorized by the copyright owner that is delivered in the form of packaged media (such as a prerecorded videocassette or DVD). Both are lawfully made copies and are fixed in tangible media. The first sale doctrine applies to both.

Allowing consumers to exercise their right to rent or resell lawfully acquired digitally delivered works will not facilitate unlawful exhibition, reproduction, or distribution of copyrighted works.

The technology exists today, through digital rights management, to facilitate the lawful distribution of such works while respecting the first sale doctrine and deterring piracy. In addition, the Ninth Circuit's decision in *Napster, Inc. v. A&M Records* demonstrates that copyright owners have adequate legal remedies at their disposal to address online piracy.

ANTITRUST CONCERNS

Access control technology and end-user license agreements can also be abused to suppress retail competition by concentrating greater control over distribution in the hands of a small number of entertainment conglomerates, to the detriment of consumers and small businesses. It must be understood that entertainment products are not fungible. A consumer that seeks to view "Gladiator" will not be fully satisfied by substituting "Traffic." Rather, for motion pictures, the retail competition occurs not between products, but between retailers, who compete on price, selection, terms, location, customer service, and other factors.

The proliferation of excessive access control technology and hidden or "click-through" end-user license agreements would deprive consumers of the value and flexibility that they currently receive from packaged entertainment. It could eliminate retail competition and substitute uniform pricing and other uniform terms and conditions on the sale of movies, effectively extending the carefully delineated rights contained sections 106 and 106A of the Copyright Act into wholesale controls over distribution to the ultimate consumer. Such technologies are also capable of being used to obliterate the lawful secondary market for used entertainment. Consumers could then be prevented from loaning movies to a family member or friend, reselling them, donating them to charitable organizations, or even, according to some of the current business models, bequeathing them in their wills.

Competition in the distribution of copyrighted works is largely non-existent until the product passes to distributors and retailers. If video retailers cannot participate in the distribution of digitally downloaded movies, either as a lawful reseller or a rental outlet, the neighborhood video store will rapidly fade from the scene. They would be replaced by direct distribution by copyright owners. Consumer choice and competition would be further eroded.

More than 50 years ago, the Supreme Court in *United States v. Paramount Pictures*, 334 U.S. 131 (1948), struck down pooling arrangements and joint ownership agreements designed to give movie studios control over the distribution of motion pictures in theaters. It also struck down the "block booking" practices in which the motion picture studios refused to license one or more copyrighted movies unless another undesired copyrighted movie was accepted. In *United States v. Loew's, Inc.*, 371 U.S. 38 (1962), the Supreme Court once again condemned block booking and related efforts to suppress independent distributor decisions. Online distribution of entertainment by copyright owners armed with restrictive technologies raises the potential for the types of anticompetitive behavior that the Supreme Court forbade in *Paramount* and *Loew's*.

PRIVACY CONCERNS

Digital download systems that require consumers to surrender personally identifiable information or require retailers to provide information about their customers to copyright owners also raise concern. Such data mining mechanisms may violate the Video Privacy Protection Act (18 U.S.C. § 2710) and force retailers to share their customer lists with potential competitors. Knowledge of which movies a consumer chooses to rent or buy from their local retailer, whether in a brick and mortar store or online, should remain off limits to third parties, including the owners of the copyrights in those movies.

CONCLUSION

While VSDA is deeply concerned about the overreaching that appears to be part of some emerging business models for online entertainment, we do not call upon Congress to resolve this dispute at this time. Copyright law is a balance between the protection of intellectual creations and the promotion of broad public dissemination of these creations in a manner that benefits society as a whole. We must proceed carefully lest we upset this well-crafted, time-tested balance. Accordingly, we do not currently support any revision of the first sale doctrine. The doctrine has proven itself and facilitated the best system for delivering movies and video games to the home available anywhere in the world-and greatly favored copyright owners along the way. Although congressional action may provide much-desired clarity, we believe that our differences with copyright owners should be resolved in industry-

to-industry discussions, if at all possible. However, should copyright owners seek to eliminate effective competition from retailers and thereby deny consumers the widest access to movies and games at the lowest possible prices, we will seek prompt and decisive congressional action.

Thank you for the opportunity to submit our views.

