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PRIVACY AND PIRACY: THE PARADOX OF ILLEGAL FILE SHARING ON PEER-TO-PEER NETWORKS AND THE IMPACT OF TECHNOLOGY ON THE ENTERTAINMENT INDUSTRY

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

SEPTEMBER 30, 2003

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TUESDAY, SEPTEMBER 30, 2003

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:08 a.m., in room SD–G50, Dirksen Senate Office Building, Hon. Norm Coleman, Chairman of the Subcommittee, presiding.

Present: Senators Coleman, Levin, Collins, Sununu, Levin, Carper, and Pryor.

Staff Present: Raymond V. Shepherd, III, Staff Director and Chief Counsel; Joseph V. Kennedy, General Counsel; Mary D. Robertson, Chief Clerk; Katherine English, Counsel; Mark Greenblatt, Counsel; Kristin Meyer, Staff Assistant; Elise J. Bean, Democratic Staff Director and Chief Counsel; Rob Owen (Senator Collins); Joe Bryan and Mike Kuiken (Senator Levin); John Kilvington (Senator Carper); Tate Heuer and Gita Uppal (Senator Pryor); Juria Jones (Senator Specter); Mark Keam (Senator Durbin); and Adam Sedgwick (Senator Lieberman).

Senator COLEMAN. We are going to call to order this hearing of the Permanent Subcommittee on Investigations, "Privacy and Privacy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry."

We have with us my colleague, the distinguished Senator from California, Barbara Boxer. Senator Boxer, I know you wanted to make an introductory statement. What I'm going to do, as an accomodation to your schedule, is give you an opportunity to make your statement now before we begin our formal statements.

TESTIMONY OF HON. BARBARA BOXER, A U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator BOXER. Senator, thank you so much, Senator Coleman, Senator Carper, and others who will come, for giving me this opportunity. We had a hearing on this subject at which you testified, my friend, Senator Coleman, so this is my second round in putting out some of my thoughts, and I will try to keep this as closely knit as I can.

First of all, I have four points to make. The first point is that downloading copyrighted works is theft, and I think if there is any-

thing else coming out of this hearing other than that, it is a real problem.

Senator Levin, I was just saying that I have four points to make that I hope you will keep in mind. First, that downloading copyrighted works is theft, plain and simple. Second, it is not a victimless crime, as you will find out today. Third, the file-sharing networks themselves constitute a threat to privacy. And fourth, these networks are no place for children. Those are the four points and I will go quickly through them.

First, the issue of theft. Peer-to-peer sharing is fine, but not if they are copyrighted works. That is just the fact. You can't have a law without being able to enforce it or no one will pay any attention to it.

We know it is legal, again, to share non-copyrighted work, but if it is copyrighted, it is stealing, and whether you are stealing it from the store or on the Internet, there has to be consequences, I believe. Otherwise, it will continue.

Now, we all know about the 1998 Digital Millennium Copyright Act. A lot of us were involved in putting it together. And in the course of that, the Internet service providers said, look, we don't want to be responsible for this illegal downloading. So we will support turning over the records to—I don't mean—I should say, turning over the information to the record companies as an exchange for us not being liable.

So I think that for them now to say that they won't cooperate is just going against what they agreed to do. That is not right. The one thing I have learned about this business that we are in is that you give a handshake, you give your word, and you stick with it. That is important.

Now, the second point. Stealing copyrighted work is not a victimless crime. It threatens our creative industries and our artists, and there is an artist here today, and I assume a lot of people are here because of that. I thought it was us—— [Laughter.]

But then I realized, my staff said, no. So the fact is, we have victims.

As visual proof, there is a chart that shows photographs taken by the Nashville Song Writers Association of a series of buildings now for lease that once housed music publishing companies on Nashville's famous Music Row. Each of these closed businesses represents jobs lost, and Mr. Chairman, regardless of our party, we are in it to fight for jobs for our people. We are losing jobs.

Two song writers who have written for famous artists, Kerry Chader and his wife, Lynn Gillespie Chader—I hope I said it right—wrote to me last week, and they wrote, "Our income fell over 60 percent from 2000 to 2002. In 2001, we were forced to declare bankruptcy. After more than 100 songs recorded between my husband and myself, we were forced to seek outside employment. In 2002, we were expecting a check for royalties in the neighborhood of $5,000. When the check came and we opened it up, it was $17.53," she writes. What a shock. And they attribute their losses to illegal downloading, which they refer to as "downlooting."

So according to the Record Association, the industry has lost 25 percent in sales over the last 3 years. It has gone from a worldwide $40 billion industry in 2000 to a $26 billion industry in 2002.

My third point is that file-sharing networks themselves pose a great threat to privacy. Most users have no idea that they are frequently sharing their private documents with everyone else on the network, and you can see this, and since my time is running short, I hope you will take a look at this.

This is a chart [1] that essentially says—it highlights that you will share files that are in your, "shared folder." It allows you to add any other folder you wish. Users often make sensitive files available unwittingly to everyone on the network by putting those files in the wrong folder. In a search of one peer-to-peer network, a House committee report found 2,500 Microsoft Money backup files. Each of these files stores a user's personal financial records and all were readily available for download.

I will complete this in less than a minute, if I might.

So here we have a situation where we are worried about the privacy of the people who are illegally downloading, although I have to say, and no one likes these lawsuits, it is awful, but if someone came in and had a mask on, as they have done, they still do, to a store and they were anonymous, they are still a thief, even though you have got to find out who they are.

So the fact of the matter is, let us not just say we are trying to protect—hopefully, we are not saying we are trying to protect privacy of people who are stealing. As unpleasant as it is, believe me, it is very unpleasant.

The fourth issue, we must address how these networks expose children to pornography. Children don't belong on these networks. According to the General Accounting Office, "Juvenile users of peer-to-peer networks are at significant risk of inadvertent exposure to pornography, including child pornography," and this is another chart [2] from Kazaa. You can see on this chart the user has put in a search for the Beatles. That search then generates a series of files, and highlighted on the chart, you see when the user selects Beatles, a title that says "Drunk Teen Sex 2," which is a teen porn file. So this means your child could think she is downloading a Beatles song and be downloading pornography, and I think parents need to know about this. There are other unintended consequences of this.

In conclusion, I believe—and you can play a major role in this—that coming out of this hearing as well as the Commerce hearing, we should bring out these points. Clearly, it is wrong, what is happening. This is a crime. There are real victims. Inadvertently, people are losing their privacy, and inadvertently, youngsters are being exposed to pornography.

So for all those reasons, I hope that the message out of this hearing will be, let us find ways we can all work together so that we can solve this problem. Instead of just saying, let us open up the Digital Millennium Copyright Act, rewrite it and stop what I think is the first thing that is making an impact, which is enforcing this law. It is actually making an impact. Teens are saying, gee, maybe this was wrong. I never saw it before as stealing.

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[1] See Exhibit 6a. which appears in the Appendix on page 164.
[2] See Exhibit 6b. which appears in the Appendix on page 165.

I thank you so much for giving me this privilege to open up this hearing. As you know, this is very important to my State of California and the millions of people who live there and, I think, to people all over the country. Thank you.

Senator COLEMAN. Thank you, Senator Boxer. I appreciate your passion and perspective on this issue and I look forward to working with you on it.

Do my colleagues have anything that they would like to ask Senator Boxer?

Senator LEVIN. Just to thank Senator Boxer. Thank you, Senator Boxer. Thank you for your total commitment to the State of California and to the jobs that are impacted by what is going on through this downloading process. We thank you for your very strong statement.

Senator BOXER. I appreciate it.

Senator COLEMAN. Thank you.

OPENING STATEMENT OF CHAIRMAN COLEMAN

Senator COLEMAN. Before I begin with the first full panel, I will deliver my opening statement. I am pleased to be joined with my colleague and distinguished Ranking Member, Senator Levin.

On September 8, the Recording Industry Association of America (RIAA) fired its first volley of copyright infringement lawsuits in its battle against illegal downloading. The industry promised to "approach these suits in a fair and equitable manner," and that it is initially focusing on "egregious offenders who are engaging in substantial amounts of illegal activity."

I am grateful that the documents provided to this Subcommittee substantiate that claim. However, there is nothing under current law that requires the RIAA to target only "egregious" offenders in the future. There is nothing in the current law that restricts the scope of the RIAA's use of subpoenas to ferret out unlawful downloaders.

It has been these developments that led to my concern about the use of subpoenas to combat the illegal taking of copyrighted music files online—and the potential for abuse of the legal process. However, I am also troubled by the use of the DMCA subpoena procedure and lawsuits to spear the registered owner of the computer rather than perhaps the actual user of a P2P operation like Kazaa. The Subcommittee has been in contact with numerous individuals whose family members, friends, or roommates use the Kazaa service. Unfortunately, these unsuspecting individuals are now the targets of subpoenas and lawsuits.

Recently, I had the honor of providing a brief statement to Senator Brownback's hearing before the Commerce Committee on "Cyber Identity, Privacy, and Copyright Protection." It was the hearing in which Senator Boxer participated. There, I stated the principles that are the basis for our hearing today.

On the matter of subpoenas, I am concerned about the scope and the impact of the broad powers extended to the RIAA and other copyright holders to issue these subpoenas. Is it possible for innocent people to get caught in the legal web that the RIAA is trying to create to stop illegal piracy?

I believe we must review the potential civil and criminal penalties needed to ward off the theft of copyrighted materials, and determine if such measures will work.

As it relates to the use of technology in general, I am troubled by the growing use of systems and devices to reach into our online lives and pluck out information about us with or without our knowledge. This is particularly relevant here, since technology is being used not only to steal the work of artists—but to prove that someone has, indeed, stolen it.

In addition, part of our continuing inquiry will address why P2P networks do not proactively prevent this illegal activity from occurring initially and how P2P networks like Kazaa envision moving from a business model predicated upon illegally trading songs to a legitimate business model that derives revenues from licensed copyrighted intellectual property.

There is more at issue here than just subpoenas—and the impact of the use of the power of subpoena and threat of legal action to compel consumers to cease and desist.

I believe the very future of the American music and motion picture industry is at stake—and, with it, a major contributor to our Nation's economic stability.

I am pleased to have two leaders of the entertainment industry here with us today—Mitch Bainwol, CEO and Chairman of the Recording Industry Association of America, and Jack Valenti, President and CEO of the Motion Picture Industry Association of America.

As Mr. Valenti has previously noted, the movie industry alone accounts for 5 percent of our Nation's economic output. And, as both Mr. Bainwol and Mr. Valenti have made clear, the act of downloading the work of their members without their permission is illegal—and, is contributing to a significant economic decline in their respective industries.

I think we can all agree that the growth of current, and future, technologies bodes well for improving the quality of our lives and productivity, . . . but, we must also accept that it also could spell economic doom for the entertainment industry.

In just a short time, it will be possible to download a full-length motion picture movie in minutes, and to distribute that movie across the world before it makes its cinematic debut.

I believe we have the capacity to preserve the economic, artistic, and cultural integrity of our arts and entertainment industry in America. It will take a concerted, cooperative effort among all involved to make it work.

With us today are others who are impacted by those changes in technology—those who own the brick-and-mortar retail outlets that are suffering from a decrease in the over-the-counter sales of CDs and other music products.

And, I want to thank another witness, Lorraine Sullivan, who is the recipient of one of the subpoenas issued by the RIAA. Her testimony will help our broader understanding and discussion today about the impact of such suits against music lovers—and what the potential ramifications may be for future customers of the industry.

We have other issues that must be addressed today.

Those who facilitate illegal file-sharing are also here with us this morning to present their side of the story.

Kazaa has over 60 million individuals who download. Yet, they have been accused of aiding and abetting those who willfully violate copyright laws. There are a number of compelling issues that must be addressed. Kazaa asserts they do not condone illegal file-sharing and that they want to move toward a legitimate business model. This raises some important questions. Such as, if the financial viability of the Kazaas of the world is based upon illegally trading files, what incentives do they or consumers have to change their behavior? What prevents them from more boldly and openly informing their users about illegal activity?

We also have with us today two artists, L.L. Cool J and Chuck D, who I hope can shed some light from an artist's perspective, on what they see to be the changing nature of the music industry—and for them what has been the solution to the intricate balance between artistic integrity—and, quite frankly, making a living.

Finally, we will end our hearing today with a discussion of the ethics of downloading and the potential need for new business models. Have we inadvertently created a culture today that encourages the very behavior that today we feel needs to be corrected? Let me be clear. Downloading someone else's property without their permission is illegal, period. Yet today, there are 60 to 90 million people who use P2P networks, and I believe that is just in the United States, who use P2P networks to illegally trade copyrighted material.

Many of these users are teenagers or younger. This generation of kids needs to be made aware that they are engaging in illegal behavior. I do not believe, however, that aggressively suing egregious offenders will be sufficient to deter the conduct of an entire generation of kids.

As a former prosecutor, I am troubled by a strategy that uses law to threaten people into submission. Yet, as a former prosecutor, I am also troubled by a prevailing attitude that says because technology makes it free and easy, it is OK to do.

I believe solving this problem will require a way of thinking that allows the industry to protect its rights, but to do it in a way that creates new consumers by intellectually and financially investing in creative methods of delivering of music to fans.

Technology and the Internet offer great hope for a brighter future, but with it comes with great concern over how they are used and how property rights are protected. It is clear today that the law, technology, and ethics are out of sync. They are woefully out of step with one another. Hopefully, the dialogue that we engage in here today will be the factual and intellectual foundation upon which we can engineer some thoughtful and practical solutions for the future.

The prepared opening statement of Senator Coleman follows:

OPENING STATEMENT

SENATOR NORM COLEMAN

Chairman

Permanent Subcommittee on Investigations

Hearing On

PRIVACY & PIRACY: THE PARADOX OF ILLEGAL FILE SHARING ON PEER-TO-PEER NETWORKS AND THE IMPACT OF TECHNOLOGY ON THE ENTERTAINMENT INDUSTRY

September 30, 2003

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There I stated principals that are the basis for our hearing today:

* On the matter of subpoenas, I am concerned about the scope and the impact of the broad powers extended to the RIAA and other copyright holders to issue subpoenas. Is it possible for innocent people to get caught in the legal web that RIAA is trying to create to stop illegal piracy?

* I believe we must review the potential civil and criminal penalties needed to ward off the theft copyrighted materials, and determine if such measures will work,

* As it relates to the use of technology in general, I am troubled by the growing use of systems and devices to reach into our online lives and pluck out information about us with or without our knowledge. This is particularly relevant here since technology is being used to not only steal the work of artists -- but to prove that someone has indeed stolen it.

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What prevents them more boldly and openly informing their users about illegal activity?

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As a former prosecutor, I am troubled by a strategy that uses the law to threaten people into submission. Yet, as a former prosecutor, I am also troubled by a prevailing attitude that says because technology makes it free and easy, its okay to do.

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Technology and the Internet offer great hope for a brighter future – but with it comes great concern over how they are used and how property rights are protected.

It is clear that, today, the law, technology and ethics are out of sync.
They are woefully out of step with one another. Hopefully, the dialogue that we engage in here today will be the factual and intellectual foundation upon which we can engineer some thoughtful and practical solutions for the future.

Senator COLEMAN. With that, I would like to turn the podium over to my distinguished Ranking Member, the Senator from Michigan, Senator Levin.

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Thank you, Mr. Chairman. Thank you very much for calling this hearing. It is a very critically important hearing for the reasons that you gave and Senator Boxer gave and your leadership is going to be critically important in trying to find a resolution to the issues which you describe.

Today, we face a collision of two worlds. One is the world of copyright law. The other is the real world, where new Internet technologies like file sharing are enabling hundreds of millions of people to instantly exchange movies, music, and other copyrighted works online for free. In the world of copyright law, taking someone's intellectual property is a serious offense, punishable by large fines. In the real world, violations of copyright law over the Internet are so widespread and easy to accomplish that many participants seem to consider it equivalent to jaywalking—illegal but no big deal.

But it is a big deal. Under U.S. law, stealing intellectual property is just that—stealing. It hurts artists, the music industry, the movie industry, and others involved in creative work. And it is unfortunate that the software being used—called "file sharing," as if it were simply enabling friends to share recipes, is helping create a generation of Americans who don't see the harm.

The Internet and related technologies, if used properly, have the potential to expose millions of people to creative work that would otherwise not be seen or heard. The question is whether their potential will be realized at the expense of artists, authors, software developers, scientists, and others who rely on copyright protection to earn a living.

The issue we will be struggling with today is what to do about what I hope is acknowledged to be a problem. How do we instill in people that downloading a song or a movie off the Internet, without permission, is like stealing a CD from a store? If the recording industry's approach—filing lawsuits against alleged infringers—is not the right answer, what is the right answer? Is it technologically feasible for software developers to take steps to prevent their software from being misused to steal copyright works? If so, are they willing to take these steps voluntarily or must we require them to do so?

Our copyright laws were designed to protect a person's intellectual property—a song, an invention, a work of art, a novel. But the use of new file-sharing software is growing so rapidly that the law has badly lagged behind.

The Subcommittee obtained copies of more than 1,000 RIAA subpoena requests and subjected them to a general review as well as subjecting 42 randomly selected requests to a more detailed investigation. The Subcommittee's detailed review of the 42 subpoenas found that the Internet user with the fewest number of songs had made available about 600 songs for others to copy, while the Internet user with the highest number exceeded 2,100 songs. Many had made over 1,000 songs available for copying on the Internet. There

was no evidence, in this survey at least, of subpoenas directed to users who had made available only a few songs.

Software providers will play a key role in determining whether their file-sharing technologies evolve into tools that promote respect for creative work or instead promote copyright infringement. Certain developments so far have not inspired confidence.

With regard to protecting copyrights, the largest software provider apparently failed to incorporate some elements that could help fight infringement and that company has taken steps that hinder rather than facilitate timely reminders from copyright holders to file sharers that the unauthorized sharing of copyrighted materials violates U.S. law. While people who download copyrighted works and make them available for others to copy should be held accountable for their actions, those providing the underlying software should also take reasonably available steps to protect copyrights.

Internet technologies are changing how many Americans find, listen to, and buy music and movies. Trips to record stores are giving way to sessions on the Internet. Movie videos are increasingly online and available to those with Internet know-how. We must search for ways to accommodate the reasonable and appropriate use of these new technologies while also maintaining the integrity of copyright laws critical to protecting and encouraging creative work.

Again, I thank you, Mr. Chairman, for calling this hearing and for your leadership in this area.

The prepared opening statement of Senator Levin follows:

STATEMENT OF SENATOR CARL LEVIN (D-MICH)
BEFORE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
ON
PRIVACY & PIRACY:
THE PARADOX OF ILLEGAL FILE SHARING ON PEER-TO-PEER NETWORKS AND THE IMPACT OF TECHNOLOGY ON THE ENTERTAINMENT INDUSTRY

September 30, 2003

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But it is a big deal. Under U.S. law, stealing intellectual property is just that – stealing. It hurts artists, the music industry, the movie industry, and others involved in creative work. And it is unfortunate that the software being used -- called "file sharing" as if it were simply enabling friends to share recipes -- is helping create a generation of Americans who don't see the harm.

The internet and related technologies, if used properly, have the potential to expose millions of people to creative work that would otherwise not be seen or heard. The question is whether their potential will be realized at the expense of artists, authors, software developers, scientists and others who rely on copyright protection to earn a living.

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The numbers suggest that we have to do something. Over the past few years, nearly 280 million people have downloaded the popular file sharing system called Kazaa. That's nearly one download for every man, woman, and child in the United States. Kazaa estimates nearly 150 million people now use the company's software, with about 60 million in the United States alone. That figure is astounding. But other numbers that are equally astounding.

According to the Recording Industry Association of America, at any given moment, there are as many as 5 million users online offering nearly 1 billion files for sharing through various

peer-to-peer software systems.

A February study by Palisades Systems analyzed file searches on one peer-to-peer network. A random selection of 400,000 searches found that music searches were 38% of the total, and that 99% of those music searches were for copyrighted material.

Which brings me to another number – 2. It takes about 2 minutes using a high speed internet connection to download a copyrighted song.

Our copyright laws were designed to protect a person's intellectual property -- a song, an invention, a work of art, a novel. But the use of new file sharing software is growing so rapidly that the law has badly lagged behind.

Our copyright laws provide copyright holders the exclusive right to reproduce and distribute their work. At the same time, the law contains an affirmative defense for "fair uses" of copyrighted works, such as for limited personal use, teaching, or in a news report. But allowing a single user to share a copyrighted work with many – perhaps millions of other persons – goes beyond any reasonable concept of fair use. Artists who wish to make their music available for free on the Internet are not precluded from doing so, but if our copyright laws are to remain credible, they must be able to protect the rights of artists who don't want their music shared in that way.

In 1998, Congress enacted the Digital Millennium Copyright Act providing copyright holders with new authority to fight copyright infringement, including the ability to obtain a court order to compel Internet service providers to identify persons who download or make available to others copyrighted materials.

The law does not require that notice be provided to the Internet user whose personal identifying information is being supplied to the copyright holder, although some service providers are voluntarily providing notice to their customers of the subpoena requests. The absence of a notice requirement and a reasonable period for a customer to respond to a subpoena seem unnecessary. After all, these cases aren't like money laundering investigations, where a subpoena might tip off the subject and allow them to flee elsewhere to commit more illegal acts. To the contrary, in these cases, notice of a subpoena might bring a quicker end, indeed a voluntary end, to illegal file sharing.

In the first few years after its creation, the DMCA subpoena authority was rarely, if ever, used. But in the last three months, the recording industry has issued more than 1600 subpoena requests to acquire identifying information on individuals who are alleged to have infringed on the copyrights of musicians and record companies. It has also filed more than 260 lawsuits based upon the information obtained from those subpoenas.

The Subcommittee obtained copies of more than 1,000 RIAA subpoena requests and subjected them to a general review as well as subjecting 42 randomly selected requests to a more detailed investigation. The Subcommittee's detailed review of the 42 subpoenas found that the

Internet user with the fewest number of songs had made available about 600 songs for others to copy, while the Internet user with the highest number exceeded 2100 songs. Many had made over 1,000 songs available for copying on the Internet. There was no evidence, in this survey at least, of subpoenas directed to users who had made available only a few songs.

Software providers will play a key role in determining whether their file sharing technologies evolve into tools that promote respect for creative work or instead promote copyright infringement. Certain developments so far have not inspired confidence. One example is the decision taken by the parent corporation of Kazaa to incorporate in an offshore jurisdiction in the South Pacific, an island called Vanuatu, which this Subcommittee has investigated in the past and found to have excessive secrecy laws and weak law enforcement. With regard to protecting copyrights, Kazaa's software also apparently fails to incorporate some elements that could help fight infringement and the company has taken steps that hinder rather than facilitate timely reminders from copyright holders to file sharers that the unauthorized sharing of copyrighted materials violates U.S. law. While people who download copyrighted works and make them available for others to copy should be held accountable for their actions, those providing the underlying software should also take reasonably available steps to protect copyrights.

Internet technologies are changing how many Americans find, listen to, and buy music and movies. Trips to record stores are giving way to sessions on the Internet. Movie videos are increasingly online and available to those with Internet know-how. We must search for ways to accommodate the reasonable and appropriate use of these new technologies while also maintaining the integrity of copyright laws critical to protecting and encouraging creative work. I commend the Subcommittee Chairman, Norm Coleman, for his leadership on this issue and look forward to the testimony today.

Senator COLEMAN. Thank you, Senator Levin.

With that, I would now like to welcome the first panel of witnesses at today's important hearing. Mitch Bainwol is the Chairman and CEO of the Recording Industry Association of America. Jack Valenti is the President and CEO of the Motion Picture Association of America. L.L. Cool J is a renowned recording artist. And finally, Mike Negra, President of Mike's Video.

I thank you all for your attendance at today's hearing and look forward to hearing from each of you.

Before we begin, pursuant to Rule VI, all witnesses who testify before this Subcommittee are required to be sworn in. At this time, I would ask you to please stand and raise your right hand.

Do you swear the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. BAINWOL. I do.

Mr. VALENTI. I do.

Mr. COOL J. I do.

Mr. NEGRA. I do.

Senator COLEMAN. Thank you very much.

With that, Mr. Bainwol, we will go first with your testimony. We will hear then from Mr. Valenti, followed by L.L. Cool J, and finish up with Mr. Negra. Gentlemen, I would like you to keep your oral testimony to 5 minutes. There may be written testimony and we will, at your request, enter that into the permanent record. But if we do 5 minutes, and I will hold you to that, that will then give an opportunity for my colleagues to be able to submit questions.

With that, Mr. Bainwol, you may begin.

TESTIMONY OF MITCH BAINWOL,[1] CHAIRMAN AND CHIEF EXECUTIVE OFFICER, RECORDING INDUSTRY ASSOCIATION OF AMERICA, WASHINGTON, DC

Mr. BAINWOL. Thank you, Senator Coleman. I appreciate that. Chairman Coleman, Senator Levin, and Members of the Subcommittee, my name is Mitch Bainwol. I am Chairman and CEO of the RIAA. Having spent much of the last 15 years working for this institution and for Members of the Senate, it is a special privilege for me to be here today, but I have got to say, I am more comfortable on the other side of the dais. [Laughter.]

It is also an honor to share this witness table with Jack Valenti, who has done this a time or two, and with Mike Negra and the incomparable L.L. Cool J.

Over these last 4 years, domestic revenues in the music industry have plummeted from $15 billion to $11 billion. The slide on the global side has been even worse. The primary cause: Piracy. The consequence: Lost American jobs, about 4,000 jobs directly in the previous 2 years alone. That does not include the enormous retail losses that Mr. Negra will address shortly. He is the human face of piracy. Everyone in the magical chain that brings music to consumers is affected. They are the human toll—song writers, artists, backup musicians, clerks, truck drivers, everyone.

[1] The prepared statement of Mr. Bainwol appears in the Appendix on page 78.

The scope of the piracy problem is made clear when you note that the number one downloaded site in America is Kazaa software, which has been on the top 50 list for 74 weeks. At least four other P2P systems are also on the top 50 list. There are tens of millions of Americans, as you have noted, Mr. Chairman, who download music for free, most of it illegally. At any given point, three to five million people are on the Internet downloading music, violating U.S. copyright law.

Any individual downloader may feel pretty innocent taking intellectual property off the Internet, presuming a victimless crime. But when you aggregate the universe of downloaders, you find a piracy problem of enormous dimension, and that produces an unacceptable human toll, victims in the creative community.

The law is clear, yet the understanding of the law is not clear. Why? In large part, it is because the file-sharing networks like Kazaa deliberately induce people to break the law. A recent independent study by Palisades suggests that 99 percent of all the audio files on the Internet were copyrighted, and 97 percent of all files were either copyrighted or pornographic. These networks, the Kazaas of the world, functionally are illegitimate platforms. They are cannibalizing a great American industry.

The RIAA embarked on a campaign to get the message out years ago—paid print, broadcast ad, op-eds, websites, instant messages to P2P users until Kazaa turned off the IM function. But we found that P2P activity continued, so we took the next step, enforcement. It has been painful and it has been difficult. It was a last resort, but it is building awareness rapidly.

From December of last year through early June of this year, public opinion on the legality of trading held constant. About a third said it was illegal. After announcing our intent to enforce our rights, but before the lawsuits were actually filed, that number soared to about 60 percent, and about 15 percent say it is now illegal. We are building awareness rapidly and it is a function of enforcement.

Our legal actions have, in fact, triggered a national debate. That is a good thing. This is a matter that will be settled over the kitchen table, not in the courtroom. Yet we do recognize that legal action is not a panacea. While we will vigilantly defend our property rights—we have no choice but to do so—we also intend to do so in a fashion that is consistent with common sense, decency, and fairness. We would much rather make music in the studio than arguments in the courtroom.

A brighter future is evolving—that is the good news—and there are three legs to the stool. First, the foundation must be a broad societal understanding of the law and what is right and wrong. That is being accomplished.

Second, the current market for legal downloads must become even more vibrant and competitive. We are watching that marketplace explode right now—Apple iTunes, Rhapsody, BuyMusic.com, MusicMatch, to name a few. Technology giants Amazon, Dell, Microsoft are all getting into this in the next few weeks and months.

Finally, the file-sharing business must become responsible corporate citizens, moving beyond rhetoric and beyond excuses. The

systems can no longer induce music fans to break the law, to diminish their computer privacy, disregard privacy, or to compromise integrity of content.

This brighter future is just around the corner if the Kazaas of the world voluntarily implement three common sense reforms. If they do so, losses can be avoided, the record industry will be healthier, there will be more jobs, consumers will get the music how they want it, and they will respect property rights. Here is what it takes.

One, Kazaa and the other file-sharing systems must change the default systems—the default settings for the users so that American kids, teenagers, and others, are automatically and unwittingly uploading the music from the hard drive.

Two, these systems must institute meaningful disclosure. Clearly notifying the users that uploading and downloading music, copyrighted materials, without permission is, in fact, illegal. Disclosure needs to be made perfectly clear.

And third, most importantly, the P2P systems must filter out copyrighted protected works. Again, 99 percent of the materials, the audio files on Kazaa under Palisades were copyrighted materials. That stuff should be filtered out. No more excuses.

Mr. Chairman, Members of the Subcommittee, I thank you for this opportunity. We have a bright future ahead of us with technology. The answer is technology, but there is a right way to do it, there is an American way to do it, and that is you pay for what you get. Thank you very much.

Senator COLEMAN. Thank you, Mr. Bainwol. Mr. Valenti.

TESTIMONY OF JACK VALENTI,[1] PRESIDENT AND CHIEF EXECUTIVE OFFICER, MOTION PICTURE ASSOCIATION OF AMERICA, WASHINGTON, DC

Mr. VALENTI. Thank you, Mr. Chairman. I must say, before I begin, I heartily endorse what Mr. Bainwol has said. These Kazaas and Neutellas and Morpheus and the rest of them are outlaw sites who do nothing but offer illegal music and movies and the most sordid pornography that your mind can ever comprehend.

But I am very glad to be here. Let me start with a story. It is said in World War I, Marshall Foach, who was a French General, later to become the Supreme Allied Commander, was in a furious battle with the Germans and he wired back to military headquarters, "My left is falling back. My right is collapsing. My center cannot hold. I shall attack."

Some people say this is an apocryphal story, but I want to believe it is true because that is precisely the way I feel in confronting the assault on American movies and these file-stealing groups all over the country whose mantra is, as you pointed out earlier, Mr. Chairman, "I have the technological power to do as I see fit and I will use that power to upload and download movies that I don't own, but I don't care who owns them because I don't care about ownership." And that is what is going on.

I think that this Subcommittee has to understand that we are under attack, and I think this Subcommittee understands that we

[1] The prepared statement of Mr. Valenti appears in the Appendix on page 88.

have to use all the resolve and imagination we can summon to battle this piracy.

Now, this is not a peculiar Hollywood problem. This is a national issue, Mr. Chairman, because intellectual property, which consists of movies and home video and TV programs and books and music and computer software—that is the family of intellectual property—is America's greatest trade export and an awesome engine of economic growth. We comprise more than 5 percent of the GDP of this country. We are creating new jobs, not minimum-wage jobs, new jobs at three times the rate of the rest of the economy. We bring in more international revenues than agriculture, than aircraft, than automobiles and auto parts. And the movie industry alone has a surplus balance of trade with every single country in the world. I don't believe any other American enterprise can make that statement at a time, all of you Senators know, when this Nation is hemorrhaging from a $400 billion deficit balance of trade.

And, by the way, we have almost one million men and women who work in some aspect of the movie industry. These are ordinary people with families to feed and kids to send to colleges and mortgages to pay and their livelihoods are put to peril by the onslaught of this piracy.

Now, let me go to my second thing. If we just stopped right now, if the world just stopped, we would be doing fine because we could survive it. But to stand mute and inert and casually attend the ascending piracy that is ahead of us would be a blunder of the dumbest kind.

On October 2, I am going to Cal Tech to deliver the Lee DeBridge Lecture and I am going to visit their lab. Their lab several months ago announced a new experiment called FAST. FAST can download a DVD high-quality movie in five seconds. Internet II, which is a consortium of scientists in this country headed by Dr. Molly Broad, the President of the University of North Carolina, had an experiment several months ago in which they sent 6.7 gigabytes—6.7 billion bytes, which is about two-thirds larger than a movie—halfway around the world, 12,500 miles, in 1 minute. Now I am told that Internet II has another experiment going which will make the previous triumph seem like a slow freight train.

So what are we doing? We are trying, Mr. Chairman, to fight this in the best way we can. First, we have embarked upon a public persuasion and education campaign with TV, public service announcements, trailers in theaters, and an alliance with Junior Achievement with one million kids in grades five through nine studying what copyright means and how it is of benefit to this country, and to take something that doesn't belong to you is wrong, and that no Nation long endures unless it sits on a rostrum of a moral imperative, and that is being shattered, as you pointed out. There is a whole generation of people growing up that think there is nothing wrong with that.

Now, we are also intensifying a new program of law enforcement, working with the FBI and also constabularies all over the world. We are doing technological research we hope will have some benefit to us in the future.

And I might add, Mr. Chairman, that we believe that it is important to use every tool at our disposal, because if we don't, we are not going to beat this.

I am quite fascinated with what I am saying up here—— [Laughter.]

But I think I will stop right now and thank you for letting me deliver this sermon.

Senator COLEMAN. Thank you very much, Mr. Valenti. Mr. Cool J.

TESTIMONY OF L.L. COOL J, RECORDING ARTIST, NEW YORK, NEW YORK

Mr. COOL J. Beautiful. First of all, let me say that I am very honored to be here. It is a very special moment in my life.

Do people in the entertainment industry have the same rights as other Americans to fair pay for fair work? When you do something, should you be compensated for it?

My question is, if a contractor builds a building, should people be allowed to move into it for free just because he is successful? Should they be able to live in this building for free? That is how I feel when I create an album or if I make a film and it is shooting around the planet for free.

Just because, if I go to Tiffany's and steal a diamond necklace and put a picture of it on the Internet and promote it, does that mean I didn't steal, because Tiffany's became more well known after I stole their necklace? See, some of the arguments make no sense.

I don't want to attack fans because, obviously, the fans are what make us. I mean, the reason I am able to sit here right now and speak to you guys, you gentlemen, is because of the fans and the love and the support that they have shown me.

I know that coming from where I come from and seeing the things that I have seen, as an African American in America, the entertainment industry has provided an opportunity for me that I probably would have never gotten if the same climate that exists now existed when I first started. I have seen a gradual decline of my record sales, even though I have had some of the largest hits of my career recently.

People say, well, L.L., are you going to sue the fans? A journalist asked me that, and I am not trying to take a shot at journalists. I am just saying a journalist asked me. L.L., are you going to sue the fans? My question to him is, when you use your creativity and you interview people, do you write for your paper for free? Do you do what you do for free?

Do the farmers in our country—can you just go down to the farm and grab a bushel of corn and just walk away? Can you just grab up some wheat and say, bye. It is OK, because they have these new airplanes that fly around and they go by the farms and scoop up the wheat, so because they exist, these model airplanes that scoop up the wheat exist, I can just have your wheat, because it is possible.

A lot of things are possible. It doesn't make it right. If they left all of the money in the bank sitting out in the open, is L.L. Cool

J able to go in and scoop up a half-a-million dollars because it is there and it is possible?

I don't want to attack children. We have to protect the kids. I don't want to attack fans who love the music. I know there are issues, yes. Some of the CDs, maybe they were expensive. In business, sometimes things have to be adjusted and you have to make adjustments and make things right on certain levels. But at the same time, now I understand that there are sites available where you can download music for 99 cents. Some of the artists may only see a nickel out of the 99 cents. Can we at least see that? Is it all right for us to make a living as Americans?

Should Steven Spielberg not have the right to get compensated when he does a movie like "Schindler's List" or he does a movie like "Jurassic Park"? Should I not have the right? Should Elvis Presley's estate not be compensated for the work that he did as an entertainer? Should the Beatles' estate and the Beatles' catalog not be worth anything anymore after all of the work that they did in entertainment?

Artists are a huge, an extremely important part of American culture. We are the dreamers. We don't write the laws like you guys. We don't necessarily have the power on certain levels that you guys have, but we are the dreamers. This is like we are the guys who make the movies and create the scenarios where the American guy goes in and wins and the rest of the world sees it and says, hmm, America is not so bad.

We need protection. We need help. A lot of people will say, well, I will take care of myself. Don't worry about me. And there are other artists who feel differently and I understand that. I don't feel like anyone shouldn't have the right to their own opinion. I just know that when you have producers, you have the drummer who is just a session drummer, he is not L.L. He is not getting the big check and doing the movie thing and all the talk show stuff that I do, but he is on the drums. He is making a living. Or if you have a producer, a keyboardist, a song writer, these people can't live.

The entertainment industry, are we just going to give it away? We are just going to say, OK, now it is free. It is OK. And that is it?

In my opinion, I just think it is anti-American. I think the thing that makes America great is that we can make money and create jobs in all of these different ways. I am not against the Internet.

Senator COLEMAN. Mr. Cool J, I am going to ask you if you can just sum up.

Mr. COOL J. Yes. I will just say that I am not against technology. I am not against the Internet. I just wish that these things could be done—music could be downloaded legitimately. Thank you.

Senator COLEMAN. Thank you, Mr. Cool J. Mr. Negra.

TESTIMONY OF MIKE NEGRA,[1] PRESIDENT, MIKE'S VIDEO, INC., STATE COLLEGE, PENNSYLVANIA

Mr. NEGRA. Chairman Coleman and Senator Levin, distinguished Senators, I am the President and founder of Mike's Video, Inc., a small chain of four movie rental and music software stores in State

[1] The prepared statement of Mr. Negra appears in the Appendix on page 99.

College, Pennsylvania. I would like to thank you for allowing me the opportunity to tell my story, which has been mirrored all over the country these past 3 years.

I am here to support the RIAA's efforts and here is why. In 1999, our business was fantastic. That year, with five locations in two college towns, we eclipsed $3 million in music sales, ranking us in the top 50 accounts with some major suppliers. We were experiencing a rapid growth, due in large part to the market we were serving, college students.

That all changed abruptly in August 2000 when Penn State and Virginia Tech students returned for their fall semester. In both locations, sales fell dramatically. In State College, our downtown student-oriented store saw sales drop 29 percent, while in Blacksburg, Virginia, sales decreased by 25 percent. The slide continued for the rest of 2000, decreasing by 23 percent company-wide.

As you know, 2000 was the year of Napster, and college students with access to broadband Internet connections provided by the universities were among the first heavy users of P2P software. As a result, college town record stores like mine were the first to feel the brunt of lost sales. Underground retail stores sprung up in dorms and apartment buildings. Students were downloading new music before it was available in my stores and selling illegal copies to friends.

The downslide has continued ever since. In 2001, sales fell 24 percent in State College and we were forced to sell our store in Blacksburg, Virginia, due to disappointing sales. Last year, as Kazaa and other P2P services expanded, our sales continued to decline, falling another 22 percent. Finally this year, we consolidated our inventory, leaving only one music store left in our chain. What was once the cornerstone of the music buying public, college students, has now almost completely disappeared. We just couldn't compete with free.

Mike's Movies and Music will sell $1.8 million less music this year versus 3 years ago, a 70 percent reduction in sales. The trickle-down effect is enormous. For example, the State of Pennsylvania has lost $108,000 in potential sales tax revenue from my store alone. Music-related jobs and community-wide benefits, from a general manager to buyers to store managers and clerks have been eliminated at Mike's. Wages were frozen throughout the company as we struggled to overcome the revenue loss. We were forced to sell our corporate offices and relocate to makeshift offices in various stores. Major capital expenditures have been delayed. Advertising has been cut back, travel and organizational dues eliminated, and on and on.

P2P services that exist for the purpose of stealing music and movies have decimated small businesses around the country like mine, small businesses that make America work. Only 3 years after the first sign of the effects of online thievery appeared, hundreds of stores just like mine are gone and are still struggling to stay alive, while at the same time struggling with the public's suggestion that file stealing is OK and no victims lie in its wake.

I can't tell you the amount of frustration we feel as we watch our business being stolen from us. In fact, the future looks even bleaker, as another mainstay of my business, movie rentals and

sales, becomes the next battleground. We have conversations with customers who comment proudly about their "ownership" of downloaded movies. Our student-oriented store in downtown State College has seen revenue decrease by double digits, while stores outside the student influence increase.

Finally this year, because of enforcement and deterrence efforts, I can say people are starting to get it. The Category 5 level of destruction left upon the landscape of the music industry and approaching the movie industry has people like yourselves and organizations like the RIAA and Penn State at least searching for answers. It has been allowed to continue without fear of repercussion for too long.

The lawsuits recently filed by the RIAA are timely, and unfortunately, are a required addition to the educational approach used for the last couple of years. Without that deterrent, as has been proven in my little corner of the world, things will only get worse.

People have no more right, no more entitlement to steal music or movies or any other copyrighted product in a digital form than they do in a physical world. The same rules apply. The RIAA is just enforcing them.

I prosecute shoplifters in my store. If I didn't and word got out, I would have no inventory. Online shoplifting will only be stopped by aggressive enforcement that creates a deterrent effect. Please help the copyright owners protect their property. Our industries depend upon it. My fellow retailers depend upon it. Our employees and their families depend upon it. Thank you.

Senator COLEMAN. Thank you, Mr. Negra.

I know that some of my colleagues have opening statements, but in the interest of time, I wanted to forgo that and hear from the witnesses. What we will do is 7-minute rounds of questions and hopefully that will give my colleagues a chance to do a preliminary statement. Of course, the full statements will be entered for the record.

Let me begin. Mr. Bainwol, are you concerned that the decision to sue hundreds of music lovers could have a negative effect on fan loyalty and could harden consumer resistance to legitimate online sites?

Mr. BAINWOL. Concern? You can't take a decision like this lightly. The decision to move forward with the legal action was a last resort. We simply had no choice. It is the end product of a campaign that involved paid advertising plus lots and lots of free media interviews. We have tried to get the message out. The market has just fallen apart when you are competing against free, and this was the last thing we had in our quiver.

So we had to do it, and the good news is that it stimulated a national debate. Parents are going home, having that conversation with their kids over the dining room table. That is exactly what we hope to stimulate. The answer isn't lawsuits. The answer is kids learning the difference between right and wrong and technology that offers a legal way to get the music fans want.

Senator COLEMAN. There are those who are involved on the P2P side that say that the recording industry is a tough industry to deal with. They are tough to negotiate with, and if we could just sit down, we could sort this out. Do you think there is a possibility

of figuring out a way to sort this out where, in fact, you can protect copyright interests and others can engage in the business of legal file sharing?

Mr. BAINWOL. Until the P2P folks get legitimate, it is an awfully tough thing to do. The reality is, 99 percent of the traffic on those networks is illegal downloading. Maybe it is 90 percent, maybe it is 95. One study said 99. It is a totally illegitimate platform. It is Jesse James wanting to be hired at the bank. It is just silly.

Senator COLEMAN. But if we were to do something that would somehow force those involved in illegal file sharing today, they might say yes, we have changed our ways, and we now installed the filtering technology. We are doing all the things you are talking about. But, what would stop someone else from doing it? What stops somebody else from just setting up a similar operation? How do you get your arms around something that is global in nature and is subject to the flow of technology?

Mr. BAINWOL. Nobody says it is going to be easy. This is tough. But what we have to do is we have the leaders and parents send a message that taking copyrighted materials is wrong. There is an education piece to it, and we have got to find a way to foster the technology. There is no magic wand that you can wave and solve this problem. It is education. It is conversations at home. It is legal alternatives. And it is putting pressure on the P2P guys to conform to basic common decency and corporate governance standards.

Senator COLEMAN. Mr. Valenti, I know you have looked at this problem for a while, and perhaps the movie industry is in the somewhat enviable position of being able to kind of watch as this technology develops. The fast stuff isn't here yet, but it is coming. The Internet II stuff isn't here yet, but it is coming.

Can you help us a little bit in terms of what you think could be done from a software and hardware side that could have some impact? Is there something? We don't have the Dells and the Microsofts and others at the table today, and that may be another hearing. Can you tell me, do you have a vision as to what can be done on the software and hardware side that can help us solve this problem?

Mr. VALENTI. Mr. Chairman, I think that one of the aspects of a possible solution, because there is no single silver bullet, has to be technological research. Technology is what brought on this problem and technology may be the salvaging of this problem.

We are working hard on that right now. I am going to be attending a meeting in 2 days where the member companies of the association, the studios, are looking at technological research to begin that. We are already in conversation, deep conversations with the Microsofts of the world and the IBMs to see what can be done. There are a number of independent fine minds in the high-tech industry working on this.

But there has to be something else, too. There has to be an awareness on the part of the American public that this kind of scramble, taking things for free that belong to somebody else, has to be stopped. We are squandering in this country a whole moral platform that has been built, and I worry about that. I would think that this Senate and you and the rest of your Subcommittee would

be worried about that. It is a larger problem. But it is inherent in the solutions that we are looking for.

Senator COLEMAN. Mr. Cool J, first of all, you talked about fans' love and support. I do want you to know that you have that in this building. On the way over, I heard the folks who run the elevators in the Senate and the Capitol really want you to come by and say hello, so there is a lot of love and support out there. [Laughter.]

Mr. COOL J. Thank you.

Senator COLEMAN. There are those who suggest that the honor of online record and music distribution gives more power to the artist, and somehow takes it away from the record executives and gives you more power. Can you respond to that?

Mr. COOL J. I understand what you are saying. I think it is two separate issues. I think that the deal that you negotiate with your record company and your music being given away for free are two separate issues.

Yes, OK, maybe if you don't have a contract and you just started and you put your record on the Internet and people like it, you can get attention. But that was your choice. You made that choice. If another artist decides to come here today and say, hey, I choose to upload my music for free and the rest of the world can have access to it for free, that is their choice. That is their right.

But I think that from my relationship and the friends that I have in the entertainment industry, on both sides, music and film, I know that the majority of artists—the majority—want to be compensated for what they do. And ultimately, like I said before, because you are exposed, because you gain more notoriety by being shot throughout cyberspace does not make up for the crime. It doesn't change the fact that it was stolen.

Senator COLEMAN. You have already had a very successful career and I suspect there is a lot more to come. What advice—talking about choice—what advice would you give to an up-and-coming artist as to how to navigate their way through this system where you have technology offering all this opportunity.

Mr. COOL J. I think that, obviously, America is a country where the entrepreneurial spirit is everywhere, in every corner. Having your own business is always a wonderful option. Having your own label, having your own things, these are all wonderful options, but ultimately, it is great to have a great partner who can invest in you and help you to expose your product to more people all around the planet.

My advice would be to make great work, choose and figure out the business model that you want to utilize to get that work, to disseminate that work to the public, to get it out there to the public, but ultimately, either you want to be compensated or you don't. You understand what I am saying? It is whether you are anti-big industry or anti-big label and you feel you should be on a small label or you should be independent and you don't want to be associated with any of the larger companies, that is your choice. But the real question is should you be compensated for your work or not? I, for one, believe that in America, when people work, they like to be compensated.

Senator COLEMAN. Thank you. Thank you, Mr. Cool J.

My time is up, but Mr. Negra, I have one question and may come back on a second round. Do the universities have any responsibility to step out in front, and have you as an individual entrepreneur been involved in discussions with them about this problem?

Mr. NEGRA. My discussions with Penn State go back to 2001 about it. I think that they were limited in their ability of, I guess, controlling what was happening on their servers back in 2001. I think that they have some responsibility, yes, and I continue to have discussions with the university.

Mr. VALENTI. Mr. Chairman, can I break in a moment on that very subject?

Senator COLEMAN. Very briefly, because I know that my colleague, the Ranking Member, has another commitment and I do want to get to him.

Mr. VALENTI. Let me withhold that question.

Senator COLEMAN. Thank you. With that, I will turn to Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman. I would ask that my entire opening statement be made part of the record, also.

Senator COLEMAN. Without objection.

Senator LEVIN. First, let me thank each member of this panel. I just wish everybody could have heard this testimony, everybody who thinks that it is OK to download or upload copyrighted material. I wish they could have heard the clarity, the moral clarity with which you speak.

The question that I have is whether or not the message which you have provided and which we are attempting to provide needs to be reinforced by any changes in law. Are there things that we should do that would require, for instance, technological capabilities to be inserted in this software which would notify people that they are downloading or uploading copyrighted material? I think that is technologically feasible now. It is not incorporated in some of these companies' software. Should we require that it be incorporated? I am just throwing out one possibility.

But my question is, I think the message is so compelling, does it need to be reinforced by any changes in law, in your judgment? Now, you may not be in a position where you are able to answer that, but if you are, I would welcome your comments.

Mr. BAINWOL. I would make two quick comments. The first is that our natural inclination would not be to support mandates on technologies. What we need to do is have an opportunity to enforce the law and to send signals that the law matters.

We are a Nation of laws. We are in a situation where an industry is being ravaged. And what we need to do is send signals that, in fact, it is appropriate to enforce, and when people get that message, the education campaign will be complete and we are on the way to a solution.

Senator LEVIN. Mr. Valenti, I understand, and I am not a technology expert, that it is technologically feasible to require file-sharing software to include features that would discourage copyright violations, pop-up warnings, for instance. Now, if that is technologically feasible, which I understand it is, should we mandate that?

Mr. VALENTI. Senator, the movie industry has been in long years' conversation with the high-tech industry, the IT and consumer electronics industries, the computer makers, chip makers, and the consumer people. We have been meeting with them, trying to find some middle ground, some concord that then we could come to Congress and mandate.

I lament the fact that we have not been able to make the kind of progress that I hope for, but one of the solutions, one of the bullets—not all—will, in my judgment, be at some point some kind of a mandate that would be technologically feasible, possible, easy, and inexpensive, because in the long run, it is the American consumer, Senator Levin, that is going to be denied high-value programming. We want to put thousands and thousands of titles on the Internet, deploy those, dispatch them to homes all over the world at fair and reasonable prices, which is a definition to be defined by the consumer and not by the distributor. That is our aim.

Mr. NEGRA. You are insinuating that people don't know that it is wrong and that it is copyrighted material, and I believe——

Senator LEVIN. No, I am suggesting that they need to be reminded every time they do it.

Mr. NEGRA. Well, I think that Penn State students, for example, are relatively intelligent and they know that it is not—that it is wrong to do and that it is copyrighted material, and yes, I guess another line of defense per se wouldn't hurt, but I think they know it ahead of time. I just don't think they care and I think that they have this entitlement feeling, that if it is on the Internet, it must be OK. It is mine.

Mr. BAINWOL. If I could just add one thought, the folks from the P2P community will be here. Ask them if they would voluntarily have these pop-ups that tell you that you are violating the U.S. law——

Senator LEVIN. I intend to do that if I can get back here. If they say that they are not going to do it voluntarily, the question is whether it should be mandated or not.

Mr. COOL J. Yes.

Mr. VALENTI. The answer is, at some point, we probably have to do that.

Mr. COOL J. Ultimately, sir, I think that people are well aware, the general public is well aware, and the only thing that will really be a true deterrent are laws that are fairly strict and deter you from wanting to engage in this type of activity. I mean, it is like anything else. If you guys with the power don't say, hey, you can't do this, it is wrong and if you do it, this is what happens——

Senator LEVIN. We have already said that.

Mr. COOL J. Yes, sir.

Senator LEVIN. It is already against the law to do it. The question is, does the law need to be in some way strengthened to use new technologies in some way to fight this pirating. We fight the piracy when it occurs in other countries. We negotiate trade agreements with other countries trying to protect our intellectual property. Some of them continue that piracy unabated, despite those efforts. But here, if there is a technology which could be effective, should we mandate its use? That is the question which I think we need to struggle with, if it is not voluntarily used.

Mr. BAINWOL. If, in fact, the P2P community does not respond voluntarily, then they should be subject to mandates.

Senator LEVIN. The last question for this panel, and that has to do with this subpoena question. The current law does not require notice to the person whose identification information is being subpoenaed, and the question that I have is, isn't it to your advantage that person be notified that there is a subpoena that has been issued or requested, because you may be able to achieve voluntary compliance.

In other words, there is a change in law which it seems to me might be consistent with fairness that is to notify somebody that, hey, there is a subpoena out now for information relative to you. This isn't like notifying somebody who is engaged in money laundering that there is a subpoena issued, because that person might then run and try to hide the money or move the money. This is a different issue. That person is not going anywhere. Wouldn't notice of the issuance of a subpoena be consistent with fairness, but from your perspective, also lead perhaps to quick and voluntary compliance? That is my question. Mr. Cool J.

Mr. COOL J. I agree. I think that is very fair and I think it sounds very smart and it is a really creative idea and I think it is the right way to go. I definitely think it is the right direction.

Senator LEVIN. I really welcome that endorsement. I hope you will also endorse my records, by the way. [Laughter.]

Thank you all. You have been a great panel.

Mr. COOL J. Thank you very much, sir.

Senator COLEMAN. Thank you. I would note the presence of the distinguished Chairman of the Committee on Governmental Affairs. That is Senator Collins. Welcome. With that, Senator Sununu.

OPENING STATEMENT OF SENATOR SUNUNU

Senator SUNUNU. Thank you, Mr. Chairman. I have no records. I have no intention of producing records. Everyone can breathe a sigh of relief. [Laughter.]

I appreciate, Mr. Chairman, you holding this hearing. This is, obviously, an extremely important subject and one in which I take great interest. I appreciate all of the panelists, their statements, and want to reiterate the statement by Senator Levin.

The degree to which this is an important issue hinges on our respect for private property rights. I think you will find everyone on the panel committed to supporting individual property rights and sharing the belief that copyrights are part of that individual property right history that, in many ways, makes our country unique. It drives commerce. It drives business. It drives industry, whether you are in the entertainment industry or writing or producing any kind of intellectual property.

Second, I think it is important to acknowledge the right of those who are engaged in business, whether you are a recording artist or you own a business, your right to use the legal tools at your disposal to protect your property rights, your copyright. I think that is legitimate, that is fair, and has to be acknowledged, because if we don't acknowledge that, we are sending the wrong message.

There are a number of concerns here, though, and when we talk about technology and we talk about the text of the laws we write, we begin getting into slightly grayer areas. Concerns for me are, one, the very nature of the subpoena power that has been written into the MCA, the Millennium Copyright Act, and specifically the 5(12)(h) subpoena. This is a new kind of subpoena power. We need to acknowledge that. Whether we think it is a good idea or a bad idea, we have given unique new subpoena powers to copyright holders, a type of subpoena power that no other individual or entity that I know of is given, and we want to make sure it is used in an appropriate way. We want to examine the question of whether or not it is used in a way that intrudes on privacy.

And certainly a second concern is probably much greater on that side of the dais, is the way in which these technologies are going to change, one, the business models that you incorporate; two, the way these technologies are going to facilitate ever-greater volumes and ease of file sharing, and Mr. Valenti, as usual, addressed that in a very eloquent way; and finally, the way in which these new technologies, technologies that are going to come around in 5 years or 10 years, are going to make enforcement even more challenging. We can certainly hold out the hope that we will identify some technologies that make enforcement easier, but I think the history, the evolution of the Internet and processing capability and distributed networking, show that it makes enforcement, in many cases, much more challenging.

So those are the concerns that I have and I hope to explore with this panel and the next panel.

Let me begin with Mr. Bainwol, welcome. In the material we have, it noted that there were 2.6 billion downloads a month. Try as you may, you can't sue them all. I don't think that is your goal. We could probably find some lawyers that would be more than willing to try to sue them all—— [Laughter.]

But I don't think that is realistic. So in that light, can you talk a little bit about the goals of your legal strategy, the subpoenas and the lawsuits that you have pressed forward. What are the goals, and as quantitatively as possible, how will you know when you have achieved your goal?

Mr. BAINWOL. Our objective, again, is not to file lawsuits. Our objective is to create an environment in which legal alternatives can flourish. If there is a free competitor, that makes it awfully difficult to establish an economic model that can work.

But we are engaged in lawsuits. Again, it is done as a last resort. We will do it as long as necessary to get the message out and to establish the proper deterrent. Laws are there in order to defend property and we have got to enforce that law to get the message out and we will continue to do so.

Senator SUNUNU. How do you know when the message is out, though? How do you know when you have sort of achieved the goals of this legal strategy?

Mr. BAINWOL. We will know it when we see these legal offerings flourishing. We are not operating in a situation where we expect a zero tolerance on downloading. What we are looking to do is to create a marketplace that can operate, that can take hold, and my hope is, in 6 months from now, we are going to be talking about

the whiz-bang offerings that are already out there that are getting better and better and better. Kids, as a result of conversations with their parents, know that instead of going to Kazaa, they are going to go to BuyMusic.com, they are going to go to iTunes, they are going to go to MusicMatch, and they are going to find a legal way to get done what they want, which is to enjoy music.

Senator SUNUNU. Do you think the poor performance of legal options that are out there has been driven solely by the existence of peer-to-peer?

Mr. BAINWOL. One, I would not accept the premise that the performance is not good. I think if you go on some of these sites, they are outstanding. Go on MusicMatch. They opened up yesterday. I went last night. Go on iTunes. It is amazing.

But, I will say this. P2P makes it much tougher. If you are a kid and you can go out there and get it for free, why would you go to iTunes? And unless this Congress enforces our right and enforces the law and—we are going to have a tough time making that sell.

Senator SUNUNU. Mr. Valenti, you had wanted to make a comment earlier. Let me ask you a question, and if you want to stick in the comment you had missed, by all means, and that is sort of the second concern and you began to touch on it in your testimony.

How will the new technologies or emerging technologies or even existing technologies today change business models used by the entertainment industry and the motion picture industry?

Mr. VALENTI. Let me answer that by saying President Kennedy used to tell a story about a French General in Algeria who told his gardener that he wanted to plant a certain species of trees along his pebble drive to his chateau, and the gardener said, but General, this tree takes 50 years to really bloom. And the General says, my God, we don't have a moment to lose. Plant it today.

We are trying to put in place right now, Senator Sununu, Bathel plates to the future. We have been sort of relieved right now because it takes so long to bring down a movie, but I told you what is going on in Cal Tech and Internet II, what is experiment today will be in the marketplace 3 to 4 years. So we are looking 3 to 4 years in advance.

I believe that technology is going to play a large role in dealing with this, but along with that there has to be an understanding by the public that this is wrong.

What I was going to say earlier to the Chairman was, we have been working very closely with a group of universities, Rick Levin, the President of Yale, Graham Spanier, the President of Penn State, John Hennessy, the President of Stanford, Charles Phelps, the Provost of Rochester, and Molly Broad, the President of the University of North Carolina. As these students came back this year, a lot of universities gave them a code of conduct saying this is wrong and if you persist in doing this, there are penalties. They vary in substance and in heft. But they are trying to explain to students that there is a price to pay.

What the RIAA, and I am not speaking for them because I don't know their overall strategy, is trying to say is "it is wrong and this is not risk-free. There is a penalty to be paid." If we did not have the IRS auditing at least 2 percent of the income taxes in this

country, who would pay income taxes? Nobody, because it is risk-free.

And so what we are trying to do is to point out that there is a risk for this. On the other side, we are going to try to use technology to see if that will also be one of the silver bullets that we can use.

Senator SUNUNU. Thank you very much, Mr. Chairman.

Senator COLEMAN. Thank you. Senator Pryor.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Thank you, Mr. Chairman, and I would like to thank you for your leadership on having this hearing today.

And also, I need to acknowledge Senator Boxer, who was here a few moments ago. She and I have talked about this subject privately on more than one occasion, and so I just want you all to know, the people in this room, that she is not just here when the microphones are on and the cameras are on. She is very vigilant about this issue, is very concerned about this issue and wants to make sure that everyone's rights are protected.

What Senator Levin said a few moments ago—he talked about different forces colliding, and I agree with him on that. And another way to look at that, I think, is you have the one traditional American force that is foundational to American law, and that is that this country, from the foundations of our Nation, made the commitment that we are going to protect intellectual property rights. We did that through the patent law initially and we have had a strong history of doing that for the last 200-plus years. I think that is one of the reasons why our economy has historically continued to grow and continued to be as strong as it is, and that is because people in this country who are creative and who are industrious know that their rights will be protected here in America.

But at the same time, there is this other great force and it is the information age or the Internet, and it really is a revolution. It is changing the way business is done in this country. It is changing our law. It is changing people's ability to function in this country. It is something that I know the music industry has been struggling with in the last few years to try to get a handle on this. My hat is off to the ones who are trying and trying to protect the legitimate rights of the industry.

Another thing that, Mr. Chairman, I just wanted to say is that I have some concerns, just general concerns, about the concept of file sharing. I am not opposed to that concept. I understand how it can be a very positive thing, a very constructive thing, a very good thing, but I am very concerned that we need to build in more consumer safeguards with regard to file sharing.

There is a lot of inappropriate content out on the Internet. There are a lot of young people and others who come across inappropriate content that they really don't want to see, they don't have any desire to view, but nonetheless it is out there and file sharing adds to that.

There is also the problem that was mentioned in someone's opening statement about the unwanted access to your personal files. If you are not careful, you are opening all of your personal files to people who you don't know and you don't intend to do that.

Of course, a third thing about file sharing is the piracy aspect of that, which concerns me greatly.

The prepared statement of Senator Pryor follows:

PREPARED OPENING STATEMENT OF SENATOR PRYOR

Privacy & Piracy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry

Mr. Chairman, Ranking Member Levin, thank you for holding this hearing on such a timely and important issue.

The advent of the Internet has been remarkable in the ways it has changed how we as a society live our lives. Commerce, education, entertainment, and numerous other aspects of our lives have been affected and enhanced by the power and convenience of the Internet. One example, which we focus on today, the ability to share information through peer-to-peer networks (P2P), has allowed an infinite amount of information to be freely exchanged throughout the world. Clearly, this technological advance has many legitimate applications. However, there are also significant drawbacks associated with P2P technology that must be effectively examined. The most important concerns I have involve ensuring that abuses of the internet are prevented and that intellectual property laws are lawfully observed.

As a parent of two young children, I am particularly concerned about the amount of pornographic information that is rapidly becoming more and more accessible to children via the popular P2P file sharing programs. A

recent GAO report validates these concerns by pointing out that in searches involving innocuous keywords which are likely to be used by juveniles, a high proportion, about 56%, yielded search results which included links to pornographic images. So this means that, for example, when a child goes online looking for music by Britney Spears, or for Pokeman videos, and downloads images on P2P networks, he or she will quite often find files that contain very explicit pornographic images even in instances when parents have taken precautions to block their children's access to such material. We must take action to ensure that peddlers and predators on P2Ps are prevented from exposing our country's children from inappropriate and explicit material. There are also other concerns about P2P networks including serious privacy implications and the impact on the security of computers.

In addition to preventing internet abuse, it is equally important that all citizens – individual and corporate –abide by the intellectual property laws that Congress has enacted when using P2P file sharing. Federal law provides severe civil and criminal penalties for the unauthorized reproduction, distribution, rental or digital transmission of copyrighted sound recordings. As much as 90% of the distribution that occurs through P2P exchanges involves large amounts of copyrighted material. Therefore, it is imperative that Congress make clear its intent that the existing laws apply with the same

force to protect all art on the Internet as do other aspects of the copyright laws to works of art found in more traditional forums.

America is the world's largest creator, producer and exporter of copyrighted material and consumers around the world are the beneficiaries of our country's vibrant and innovative film, music, videogame and software industries. It is unfair, and indeed, unlawful that consumer or commercial pirates would seek to deny the owners of copyrighted material fair and appropriate compensation for the use or acquisition of their property.

To those of you who will make presentations today –I look forward to hearing your insights in addressing my concerns on guarding against internet abuse and enforcing the existing intellectual property laws when the public engages in file sharing across P2P networks.

Thank you, Mr. Chairman.

Senator PRYOR. Mr. Valenti, let me start with you, if I may, and it is great to see you here in the Subcommittee today. I know that your industry is, in many ways, related to the recording industry. There is a lot of cross-pollination there and there is a lot of overlap there. What has the movie industry learned from the battles that you have seen the recording industry go through and is the movie industry changing its business model or what steps is the movie industry taking to prepare itself?

Mr. VALENTI. To paraphrase Mr. Churchill, I didn't become head of the Motion Picture Association to preside over a decaying industry. And when I see the pillaging that is going on in the music industry, and L.L. Cool J has explained why the artists are worried about this, I have a few Maalox moments when I do that. [Laughter.]

We are following very closely, Senator Pryor, what is going on in the music industry right now. I have great sympathy and compassion for what they are going through, because you can bring down a song in real time, 2 or 3 minutes. One of L.L. Cool J's recordings, 3 or 4 minutes, bango, you have got it.

So we are trying to put in place a lot of things. Ultimately, Senator Pryor, our aim is to benefit the consumer. That is what this is all about. When somebody said to me, why don't you Hollywood guys stop whining and get a new business model, and I said, "boy, that is a great idea, why didn't I think of that," except there is no business model ever struck off by the hand and brain of man that can compete with free. That is an absolute truth.

So we are working with technology, we are working with the colleges, we are doing public persuasion, upping our law enforcement, all of these converging elements in order to put in place something that is going to help us survive 3 to 4 years from now when you can bring down these movies in minutes and seconds.

Senator PRYOR. Mr. Bainwol, let me ask you, if I may, there have been some press accounts of sort of innocent bystanders, so to speak, being dragged into this litigation. What safeguards are in place or should be put in place to make sure that innocent people don't get dragged into this?

Mr. BAINWOL. Great question, Senator. There are a number of safeguards that we do, in fact, employ, and more on the way.

Let me first say that we focus on the most egregious offenders. The average number of uploaded files in the 261 folks who were sued was over 1,000. I have had these CDs here for a reason and I have waited for the moment to pop them out and tell you why. It wasn't to hide my face. It is to make the point in a visual way that this is roughly the amount of material that was taken from the artists, from the L.L. Cool J's of the world. This is their work product. This is their dream. This is their future. This is what they have been compensated for. And this is what, on an average basis, what was taken down from the Internet.

It seems awfully innocent for any individual that does it, but when you aggregate it by the millions, you are killing an industry, a great American industry. That is one.

Two, based on the law and based on technology, what we do is we seek information from the ISPs on an IP account. We don't know who the individual is. What we know is, when you go on P2P,

you are offering your files up to the world. There is no privacy there. You are exposing it literally to the entire world.

We go in, we get a snapshot of that, and we are able to determine what files are out there and the IP address. That is what we send over to the ISP. They give us the name. What we get is the name, the E-mail account, the address, and the phone number. That is it. It is very limited. It is the same information that some ISPs sell to marketing partners.

Senator PRYOR. Mr. Chairman, that is all I have. Thank you.

Senator COLEMAN. Thank you, Senator Pryor. Chairman Collins.

OPENING STATEMENT OF CHAIRMAN COLLINS

Chairman COLLINS. Thank you very much, Mr. Chairman. I have an opening statement that I would like to have inserted in the record.

Senator COLEMAN. Without objection.

The prepared statement of Senator Collins follows:

Privacy & Piracy: The Paradox of Illegal File Sharing on Peer to Peer Networks and the Impact of Technology on Entertainment Industry
Statement of Senator Susan M. Collins
September 30, 2003

Good morning. Let me begin by thanking Senator Coleman for holding this hearing and bringing to the attention of this Committee a variety of issues relating to the Internet that are very interesting and quite complex.

The Internet has been a wonderful creation for our society. It allows us to instantly communicate with our family, friends, and loved-ones all over the world. We are able to shop from home and gain access to an unlimited amount of information in a very short period of time. However, the Internet has also raised many challenges for society not the least of which involves trying to apply laws meant for activities bounded by space and time to the Internet, which is bounded by neither. Freedom of speech, taxation, copyright protection, and run-of-the-mill fraud are just a few of the legal issues that the Internet has made very complicated.

Today, we will look at issues relating to illegal file sharing of the entertainment industry's copyrighted material that is available on the Internet, specifically the use of peer-to-peer networks.

This is not a new issue. It was not that long ago that Napster was making headlines and causing severe headaches within the music industry as millions of people were downloading music from the Internet for free. And though the original version of Napster has been shut down, it appears the problem is even more serious today. Without question, the music industry as well as other entertainment sectors have suffered financially from illegal copying of their material, especially over the Internet. The record industry has recently taken strong legal actions to fight and prevent the illegal file sharing of its copyrighted material. I can understand the industry's frustration. But so, too, I have

concerns about a strategy that targets individuals, often children, for enforcement action.

A fundamental issue that needs to be addressed is the notion, so prevalent across society, if you can find it on the Internet, you can have it. The Internet is a great thing but it should not be seen or used as a vehicle to evade today's laws. It is going to take common sense enforcement of our current laws and potentially new laws, and educatior to begin the process of teaching our society again that the Internet is not immune from basic property laws.

Protecting copyrighted material from piracy is not easy, especially when that material is on the Internet. Our laws protect copyright owners; but we need to find a sensible way to enforce them on the Internet. Education is one promising area; technological advances is another.

I look forward to listening to our witnesses today. I am certain they will be able to shed some light on these very complicated issues and offer ideas as to how we might be able to find some resolution.

Thank you, Mr. Chairman.

Chairman COLLINS. I want to commend you for tackling this very interesting and difficult subject. I think you have said it well when you said that the law, ethics, and technology are not in sync and it is our job to try to deal with these very complex issues.

Mr. Bainwol, in your testimony, you said that the music industry has for a number of years undertaken a massive campaign to educate consumers regarding the illegality of unauthorized distribution of copyrighted music online. Do you think that that campaign has been a success? Do you think that the average consumer who is downloading music from a peer-to-peer network realizes that they are committing essentially a theft?

Mr. BAINWOL. The campaign was necessary, but not sufficient. There is no question. What we have seen is that as much as you tell folks, until you demonstrate that there is a consequence, the behavior is not going to change.

But we also had to tell people and reach more people and penetrate with the message that downloading is wrong. The lawsuits have, in fact, done that. Earlier, I noted that we have public opinion data that suggests until June, prior to the launch of the subpoenas, that the number of folks who understood that it was illegal to download copyrighted materials was around a third. That number has doubled to about 60 percent. So the legal action is a piece of an education campaign that happens to be profoundly effective.

Chairman COLLINS. I think the lawsuits have certainly gotten everyone's attention. I would agree with you on that. I don't think the educational campaign has been successful. There is still a widespread misperception that if it is on the Internet, it is free, it is OK to use. An individual who would never think of going into Mr. Negra's store and stealing CDs sees nothing wrong with downloading the exact same music from the Internet. I think until we change how people perceive the Internet, that we are not really going to solve the root of this problem.

I am also not sure that lawsuits are the answer, and Mr. Negra, I want to ask you how you feel about the lawsuits that have been filed. I have read your testimony where you say that you think they were required, but as a small business person, how do you feel about solving this problem through litigation?

Mr. NEGRA. Well, my feeling is that something has to be done, and as a deterrent, a deterrent has to be present, very similar to Mr. Valenti's analogy to income tax. I absolutely agree with that. The entitlement issue that our customers feel, that they can go online and take that without consequence, has been the destructive force to my business and a lot of other businesses. So I am all in favor of the efforts of the RIAA towards this as long as obvious safeguards are taken.

Chairman COLLINS. Mr. Bainwol, I want to go back to you on the issue of CD prices. One of your member companies, Universal Music Group, recently announced it was going to cut the wholesale price of its CDs by three dollars. Some experts believe that this move would help reduce the pirating of music from the Internet. Is that why the prices were cut? Is this an attempt to make music at the retail level more affordable?

Mr. BAINWOL. It is difficult for me, as an association chief, to speak to the pricing practices of member companies. As a con-

sumer, lower prices certainly are attractive and I think I would leave it there.

I do want to add one other thought, though, related to your first question, if I could. We try to get a message out, and in the absence of conflict, sometimes penetration is very difficult. The legal action stimulated coverage like you would never believe. Let me read three headlines. *Newsweek*: "There is One More Talk You Need to Have." *New York Times*: "New Parent-to-Child Chat: Do You Download Music?" *USA Today*: "Parents Have a Hand in Song Swap Debate. The Kids All Do It, So Experts Say It is Up to Mom and Dad to Lay Down the Law."

The legal action is about setting up a deterrent, but it is also about making sure that parents do their duty and have that conversation.

Mr. NEGRA. May I respond to the pricing issue?

Chairman COLLINS. I was just going to turn to you for that, so please do.

Mr. NEGRA. I don't believe that the idea of CDs being over-priced was ever a concern or a conversation until "free" was the option. I have been in the business long enough to know that the value of CDs was considered, or the value of music, going back to vinyl, was fine. People responded to it, and obviously my business was strong and the business as a whole was strong until that option of "free" was out there.

And so, yes, I mean, I am very glad that Universal is reducing the price, but still, paying $9.99 for a new release versus getting it for free on the Internet is still a no-brainer to most kids.

Chairman COLLINS. That is why I am curious about the action taken by Universal. Again, I was going to ask you whether you think it will reduce the pirating from the Internet, because I personally don't think it will have any impact because, as you just said, you are comparing it to getting it for free.

Mr. NEGRA. Well, I think it is all part of the puzzle. I think that along with the RIAA's efforts towards deterrent and as far as reducing pricing and showing more value, including a DVD extra or whatever it takes to get people back into the stores, and I also believe that is one of the ways that we are going to determine whether the lawsuits are effective or not is increased traffic in physical stores as well as increased traffic on legitimate downloaded sites.

I think that it is all part of pieces of the puzzle and that it can't be just one thing. There are a number of things, and lowering the prices is certainly a move in the right direction.

Chairman COLLINS. Mr. Chairman, I will say, as someone who has no idea how to download music, that I am pleased to see the price cut. So it will make some of us who are older happy. Thank you, Mr. Chairman.

Senator COLEMAN. Thank you, Madam Chairman.

We do have two more distinguished panels, however. What I am going to do is provide an opportunity for one more 2-minute round. I think there are some follow-up questions that my colleagues have, and actually, I have two of them.

Mr. Bainwol, Senator Levin had raised the issue of fairness and notification. In the present system, subpoenas are issued to the ISP. The individual doesn't know that they are subject to any in-

vestigation. The individual, in fact, may not be the person who was actually using it, and that is some of the problems that we are seeing, moms and dads, 12-year-olds, whatever, folks who said, "It may not be me, it may be my brother or my friend." Do we need to—is there something that the Recording Industry can do voluntarily to provide more fairness?

Mr. BAINWOL. Yes, Mr. Chairman. As I noted in my testimony, there are two standards that we are living by as we go through this exercise. One is to vigorously advance our rights and the second is to try to do it in a reasonable, smart, and decent way. And toward that end, we would like to add one level to the process.

Currently, before we go to the ISP, we do provide the ISP a notice that we are going to serve them a subpoena, we are going to issue a subpoena. So they have got that and they certainly have the right, if they choose, to notify the user.

But what we are going to do in advance of filing the lawsuit against an infringer, and again, we are focusing on the egregious infringers who have downloaded something akin to what you see before me, but what we are going to do is we are going to notify folks that in a period of time, we will commence legal action. That gives them the opportunity to settle in advance of that legal action. It gives them the opportunity to make a case that we ought not, if that is their opinion. The idea is to be reasonable. We want to advance our rights and advance respect for property, but we want to do it in a fashion that is fair.

Senator COLEMAN. My concern about the settlement are the penalties that individuals face. And by the way, many of these laws were passed, in the DMCA, the Digital Millennium Copyright Act, before the advent of peer-to-peer.

I have two concerns about that. You have an individual, the little guy, a little person coming up and talking about the impact of being sued and they are being told that they face a penalty of up to $150,000 per song. Don't you think that is excessive?

Mr. BAINWOL. The $150,000 is law, and it is certainly not what we seek. What we do is leave it to the court to decide.

But let me just make a point. If you are to go out and buy CDs, say they are all on sale and you got them for $9.99, you get 120 of them, that is a lot of money. That is $1,200, roughly. Many of these settlements are not much beyond that. And I think one could argue that if we are trying to establish a deterrent, and that is something we should do to be serious about a law, that, in fact, the penalties could be even higher. But nobody is talking about $150,000.

Senator COLEMAN. But I think you have that threat and I am concerned about the excessive nature, and we talked about bringing things to people's attention. Public floggings would get people's attention, but we don't do that. I think there have got to be some limitations.

Mr. BAINWOL. But public flogging is not part of law. The $150,000 is.

Senator COLEMAN. The last comment, though, as you indicated that you would know it is successful when the legal offerings are flourishing. I think it is fair to say that one of the problems is the legal offerings are coming back way after the P2Ps took hold. I

mean, would it be fair to admit that the recording industry had not been quick enough to put on the table the kind of legal offerings that now we are talking about, and so we still haven't seen the impact of that. What I am hearing is promising, but P2Ps took hold way before the recording industry decided there should be legal offerings.

Mr. BAINWOL. The timing of this, I think, is subject to some debate. There is no question that it has been tough to get these offerings to flourish, but it is tough to compete with free. If you try to amass capital and raise money for a business proposition, it is very tough when you can go out there and download from Kazaa for free. So I have a pretty good understanding of the way marketplaces work. That is a tough thing to accomplish.

Once you begin to enforce, once we begin to set an expectation with the Kazaas of the world, then these offerings have a real live chance to flourish.

Senator COLEMAN. Senator Pryor, do you want to have any follow-up?

Senator PRYOR. I just had one quick follow-up, if I may, Mr. Bainwol, and that is I have heard the term, and I am not sure I understand how it works, but the clean state program?

Mr. BAINWOL. Clean slate.

Senator PRYOR. I am sorry, clean slate program. I can't read my own writing. Could you run through that very quickly with the Subcommittee, please?

Mr. BAINWOL. Sure. If somebody does not want to worry about subject to legal action, they can simply stop downloading and uploading illegally. That is all you have got to do, and you, in effect, got your own clean slate program.

There were some people who came to us and said, we would like a piece of paper, a sense of certification that we can sleep at night. We want something that says we are OK. And so we made available a clean slate program that gave them the piece of paper, the sense of comfort, and it is at their request.

There have been about 1,000 people who filed for that. Obviously, that is about four times the number of folks who have been sued so far. But I would suggest that there are probably hundreds of thousands, certainly tens of thousands of folks who have done the amnesty thing the old-fashioned way by stopping the illegal activity.

Senator COLEMAN. Senator Sununu.

Senator SUNUNU. Thank you, Mr. Chairman. I want to associate myself with your concerns, the remarks regarding the balance of the penalty. I don't hold the RIAA responsible for setting the $150,000 penalty, but it is important that we have in statute penalties that are commensurate with infractions, because if we don't, then they could be subject to abuse, although I don't know that anyone is suggesting at this point that RIAA has grossly misused the statute.

Mr. Bainwol, let us stipulate that the scenario we have been talking about comes to pass, that your legal strategy succeeds, that we have dramatically reduced, if not totally eliminated, the incidence of illegal downloading on peer-to-peer networks. Your offerings, as impressive as they are today, improve even further so that

your public offerings, for sale offerings of peer-to-peer downloads of the best the music industry has to offer is thriving and utilized by countless music lovers across the country and across the world. Doesn't that still leave Mr. Negra without a livelihood?

Mr. BAINWOL. The future of music is both going to be in CD form and online, and that is the nature of life. If you are 22 and under, some studies suggest that half of your music comes from the Internet. If you are over 23, most of it comes from plastic. So there is a marketplace for both.

Senator SUNUNU. But in the scenario I described, the downturn in sales, the erosion of his business profile would be just the same, if not even more dramatic, would it not?

Mr. BAINWOL. I am not sure I follow that question.

Senator SUNUNU. We are talking about a scenario where all the illegal downloading of music is replaced by legal downloading of music, unless you believe that someone would rather, instead of download it legally at the same or a cheaper price, actually go out of their home. So if you replace all the illegal downloading with legal downloading, you are still going to see an erosion of the business model and an erosion of the business that has sustained Mr. Negra and his family profitably for a number of years.

Mr. BAINWOL. There is an impact on the bricks-and-mortar side of the business if the legitimate businesses do flourish.

Senator SUNUNU. Mr. Negra, your thoughts about that prospect?

Mr. NEGRA. I can live with it. If there is a legitimate alternative, Mike's Movies and Music can move into an online service just as anybody else can. Things change.

Mr. BAINWOL. And I would add to that, a great Minnesota company, Best Buy, is, in fact, doing exactly that. Businesses are modifying their strategies so that they can take advantage of bricks-and-mortar, which is how some consumers want it, and online, which is how others, typically younger consumers, want it. The idea here is to get music that folks want, how they want it.

Senator SUNUNU. Mr. Valenti, a number of different ideas were mentioned to deal with the illegal downloading on peer-to-peer, a change in the default settings, filtering copyrighted materials, and disclosure. I think that was the third one. How do you get an offshore entity like Kazaa, which is the one we always talk about, to comply with those kinds of mandates?

Mr. VALENTI. The answer is very difficult, and that is the problem. By the way, Senator, $150,000—I can't speak for music, but for the movie industry, where the average movie made by the major studios to make and market costs $90 million, and only one out of ten pictures ever get their money back from theatrical exhibition, and that is how they become prey to the infestation of these peer-to-peer networks.

I think at some point there is going to have to be some kind of legislation that will allow this country to be able to deal with people who get on some obscure island in the South Pacific and thumb their noses at legitimacy, and there has to be some way to deal with that. I am not prepared at this time to tell you how, but I think that is absolutely essential if we are going to have any kind of order in this country.

But I think the question, going back to the Chairman, Senator Coleman, I think that you need to ask the Kazaas of the world. Incidentally, the interesting thing is, you go to business school and they tell you how you fix a profit. First, you have got to get cost of goods sold. Kazaa has a zero cost of goods sold and they are just rife with advertisements, and that is how they make a lot of money. I am ashamed to say that some segments of the U.S. Government advertise on Kazaa, which I think is shameful.

Senator SUNUNU. I appreciate that. I am not aware of that, and I think that is something that would be cause for concern.

Thank you, Mr. Chairman, and thank you for your directness, Mr. Valenti.

Senator COLEMAN. Thank you, Senator Sununu. Chairman Collins.

Chairman COLLINS. Thank you, Mr. Chairman. I have no further questions.

Senator COLEMAN. With that, thank you to the panel. We are very appreciative.

We will call the next panel, Alan Morris, the Executive Vice President of Sharman Networks Limited, the parent company of Kazaa, a peer-to-peer network; Derek Broes, the Executive Vice President of Altnet, an online business which sells recordings; Chris Gladwin, the founder and Chief Operating Officer of FullAudio Corporation; Lorraine Sullivan, the recipient of a RIAA subpoena and one of the targets of an RIAA lawsuit; and finally, another noted artist, Mr. Chuck D.

Pursuant to Rule 6, all witnesses testifying before this Subcommittee are required to be sworn. At this time, I would ask the panel to all stand and raise your right hand.

Do you swear that the testimony you will give before the Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. MORRIS. I do.

Mr. BROES. I do.

Mr. GLADWIN. I do.

Ms. SULLIVAN. I do.

Mr. D. I do.

Senator COLEMAN. Thank you very much.

Again, we will stick to 5-minute statements by the witnesses and then we will do a round of questioning.

With that, we will start with Mr. Morris.

TESTIMONY OF ALAN MORRIS,[1] EXECUTIVE VICE PRESIDENT, SHARMAN NETWORKS LIMITED, AUSTRALIA/ENGLAND/ VANUATU

Mr. MORRIS. Thank you very much, Senator Coleman. Thank you very much indeed for your leadership and the timely nature of this inquiry.

I note also holding it in this august chamber, where there has been very much drama, and we have just seen a bit of drama now. I have not recognized what I just heard. I think the notion that we acquired Kazaa at the beginning of 2002 just to make a quick buck

[1] The prepared statement of Mr. Morris appears in the Appendix on page 103.

from advertising is both offensive and naive. I used to run a major advertising agency network and there are much easier ways of doing that.

Now, when we acquired the asset, the first thing we did was remove anything at all which implied, suggested or condoned infringement. Second, we changed a lot of the settings so that people wouldn't be inadvertently sharing files.

More importantly, we engaged straightaway with Altnet, sitting here, to fulfill our goal. Our goal was very simple when we acquired the asset, and that was to become the world's largest and most effective online distributor of licensed content, and we have achieved that. We distribute more DRM-licensed files than anybody else in the world. Along with Altnet, we have been responsible for making new artists become successful, artists successful in some countries becoming successful in other countries. We have been embraced by the video games industry. They distribute massive files very successfully through the Altnet network.

And what we have recognized is that as licensed files are available, then people will use them. I think it is patronizing and unkind to say of the 60 million people worldwide that use Kazaa, over two-thirds of whom, by the way, are over the age of majority, that they would go out and steal.

There is infringement, and let me be clear, we do not condone infringement. We do not condone breach of copyright. I have run a pay-TV company. I have worked with copyrights all my life. The issue here doesn't seem to be about copyrights. It seems to be about the control of the Internet, the control of online distribution.

We approached the major labels and major studios back in May last year with a workable solution, the ability to effectively and efficiently distribute files online. We are not talking about an e-commerce website. We are talking about the mechanism which is regarded by consumer electronics companies, the computing industries, and academics everywhere as the most effective way of distributing content. And they refused to do business.

Now, it shows my age, but I was around in the age, at the time of the VCR. I was advising the MPAA at the time. It is like deja vu for me, because then I heard about the fact that advertising on TV would die, that broadcast TV would wither on the vine. That didn't happen. What we saw happening, and it is a lesson that maybe they can learn from, was they reduced the windows for exposure. Because, initially, you had to wait 5 years before you put a video out. They reduced the price and gradually they capitalized, and once a critical mass had been achieved, the motion picture industry adopted the VCR as the most profitable way of moving forward.

You have raised the issue of subpoenas, and we think they are most unfortunate. We think that rather than serving subpoenas, they should address the paradox in your title. Why sue the people who are your customers?

The reason the public has chosen peer-to-peer isn't this naive notion that they are all criminals. I really don't subscribe to that. Sixty million people are not criminals. Thirty million in the United States are not criminals. The reason is that it allows them to access files in the most effective way.

We promote independent artists. We distribute the material from upcoming bands worldwide, and these are the gold files that are at issue. People find that the peer-to-peer mechanism as opposed to the website mechanism is the most effective. There is a 95 percent efficiency in terms of distribution. Mr. Valenti talked about 4 years hence, being able to download large files using new technologies. We can offer those efficiencies today.

So I would ask the industry, why don't they license to us? It is my firm belief that this notion of copyright, important as it is, is a smokescreen. They sought to control the distribution of video material. They have demonstrated, the RIAA and the MPAA, and not necessarily the entrepreneurial heads of labels, they have always sought to control. And maybe this is the one technology they feel they can't.

Is there anybody in this room that honestly believes that peer-to-peer will go away? I could say their worst nightmare would be that responsible companies like ourselves and Altnet cease to operate, because then people would be driven to the darknets. These are the encrypted networks that are very difficult to detect. Or they would use the other means of the Internet, which they do anyway, for accessing infringing material. People have talked about downloading from the Internet, and that is true. It is not just about peer-to-peer.

So we would say very simply to the entertainment industry: Serve consumers, not subpoenas. Why litigate when they could and prepared to license to us? They were prepared to license to Altnet. Their attorneys told them not to.

Senator COLEMAN. Thank you, Mr. Morris. Mr. Broes.

TESTIMONY OF DEREK S. BROES,[1] EXECUTIVE VICE PRESIDENT OF WORLDWIDE OPERATIONS, ALTNET, WOODLAND HILLS, CALIFORNIA

Mr. BROES. Thank you. I would like to submit my written testimony into the record.

Senator COLEMAN. It will be entered in its entirety, without objection.

Mr. BROES. Thank you. First, I would like to start by saying that we do not condone copyright infringement. It is illegal.

I am a copyright owner. I have managed an Academy Award-winning actor and produced multi-million dollar films. As a technologist, I have worked for the RIAA and the MPAA on this very subject.

I would like to read you a quote. "It is not in our national interest to ban what you cannot see, to prohibit what you do not know, to turn your back on what you cannot measure." Those are the words of a man who cares deeply for copyrighted intellectual property. They are the words of Jack Valenti's recent testimony before a Congressional Committee earlier this month. The words are profound. They do not, however, reflect his industry's actions.

A closed mind is so intent on salvaging the status quo that it fails to embrace the potential of change. Our Nation is founded on the principles of accepting change, and having vision is one of our

[1] The prepared statement of Mr. Broes appears in the Appendix on page 115.

Nation's greatest attributes, whether it is a black student entering an all-white school and breaking the status quo for a great America, or our Nation's vision that space exploration is critical to future global needs. I fear, what kind of Nation would we be if we neglected to see the potential of desegregation or if we thought the moon was too far away and offered us nothing more than dust and rocks.

It is both vision and an open mind that brings me here today. It is the love of creative works that fuels Mr. Valenti's argument, and I don't think anyone can argue with that. We agree that copyright is in peril and we agree that something must be done.

Both the film and the recorded industry are building a business around peer-to-peer. They are inserting files into P2P networks in order to displace illicit files being traded. They are gathering information about users' appetite for specific artists so they can exploit that knowledge and guide marketing dollars in the right direction. They are evaluating technology, with great attention paid to the viral aspects of its users and their ability to distribute a single file to millions of users across the world without much cost at all, or effort.

The facts that they have discovered should be an encouraging sign of future business growth. I am certain that creative executives that run the entertainment companies are excited at the thought of a larger distribution platform, and I am also equally certain that the attorneys managing these companies are fearful of losing control of distribution rather than entrusting technology and users to provide their new global channels.

I can tell you with great confidence that the entire entertainment industry believes that peer-to-peer is the single most powerful distribution tool they have ever seen. The MPAA states that 400,000 to 600,000 films are being distributed every day on peer-to-peer. How much would it cost to distribute that many DVDs and could you do it in a day?

With the industry's cooperation, Altnet could exceed that number and provide it securely and in a manner where we would assure that all parties were fairly compensated. If you can imagine a few years from now a blossoming music industry and a growing film market in line with other historical technological adoption, both would be exceeding past revenues. Can you imagine that? L.L. said they are dreamers. We are dreamers.

The MPAA has urged Congress not to close the legislative door on any new technological magic that has the capacity to combat digital thievery. I would argue the same. I would ask Congress to encourage the industry to explore all sources of technological magic to combat the issue. I would ask Congress to encourage the industry to explore an open mind, including the solution that has been proven to increase revenue, mitigate piracy, displace illegal pornographic material, and proven to empower the industry and artists alike.

Altnet's technology easily enables any content owner from the music, software, film, game industry to publish their content into Altnet's secure distribution platform. These files are displayed in a prioritized listing in the top slots of the user's returning search results. Any illicit file being traded will be pushed deeper into the

system, since the licensed file is now taking up a very valuable slot in that system. Once downloaded, the user attempts to play the file. The digital rights management reaches out to deliver a license. The content owner maintains how they license and the rules surrounding a specific piece of content.

As you will read in my written testimony, Altnet is leveraging its role as a market leader by spearheading efforts to establish a viable business model for peer-to-peer providers, content owners, and users, while at the same time having the highest regard and respect for the rights of each of the parties concerned. It is very effective.

If the industry is truly enlisting the greatest technological minds to find a means to battle piracy technologically, we are right here. We are even in the same room.

Ignoring the solution just because you don't understand it is a disservice to those almost one million men and women that work to create movies and music. They are counting on the MPAA and the RIAA to find a solution.

Senator COLEMAN. I would have you sum up, Mr. Broes. Your time is up.

Mr. BROES. Yes. If the industry truly wants to find a solution to piracy and as not just a way to control the vast distribution networks of the future, they would not ban what they cannot see. They would not prohibit what they do not know. And they would not turn their backs on what they cannot measure. Thank you.

Senator COLEMAN. Thank you, Mr. Broes. Mr. Gladwin.

TESTIMONY OF CHRIS GLADWIN,[1] FOUNDER AND CHIEF OPERATING OFFICER, FULLAUDIO, INC., CHICAGO, ILLINOIS

Mr. GLADWIN. Good morning. I am Chris Gladwin, founder and Chief Operating Officer of FullAudio, the company behind the MusicNow digital music service. I would like to thank the Subcommittee for scheduling this hearing and taking the time to address some important issues in the future of digital entertainment.

I started MusicNow 5 years ago with the purpose of creating an Internet-based music service that would improve the way people explore and enjoy music. MusicNow is an independent company without any financial support from record labels or traditional music industry executives. In our 5 years, we have worked through many difficult issues with major labels and music publishers to create the first licenses for interactive music services and to build a service that consumers are willing to pay for.

We have always expected this business would be a challenge, but we never expected to be challenged by competition from black market networks that confuse consumers about intellectual property rights, that takes money from music fans without compensating creators, and that seem to thrive in the absence of law enforcement. In this challenging environment, MusicNow absolutely supports the recording industry's aggressive action in defense of its intellectual property.

Other witnesses will testify, and are testifying, that copyright and music licensing laws are so outdated that the only reasonable

[1] The prepared statement of Mr. Gladwin appears in the Appendix on page 123.

alternative is a compulsory license that strips from creators their ability to manage their own creative works. MusicNow believes otherwise, that the basic foundation of copyright law is sound and that though some of the rights and technologies are complex, these complexities should not cloud the reality of how our industry must collectively proceed in a legitimate manner.

Other witnesses will tell you that the record labels illegally or unreasonably withhold licenses. I will tell you a different story, that the recording industry and the companies in it have been slow to recognize the change in technology and consumer behavior around us, that the recording companies tried for several years to control the future of technology and consumer behaviors, and that as a result, they are exceedingly difficult to negotiate with at a time when MusicNow and several legitimate companies are trying to help them reach consumers with viable services.

But speaking as one independently funded music service provider who is in the market of selling services, it is possible, although very difficult, to license digital music. Apple, RealNetworks, the new Napster, MusicMatch, BuyMusic.com, AOL, Dell, Amazon, and others offer or will soon offer digital music services that compete with MusicNow. MusicNow and several competitors have licensed interactive digital distribution rights from all five major labels, major publishers, as well as several independent labels and publishers. Using these licenses, MusicNow has developed Internet-based music services that enable consumers to play music on demand, to play Internet radio stations, to subscribe to music, and to buy music that could be burned onto a CD or transferred to a portable device.

Black market network companies that complain that they haven't received licenses from music owners haven't worked hard enough to establish sensible business models nor to establish themselves as reputable business partners by not facilitating piracy.

Another issue raised by this Subcommittee and by advocates is whether the RIAA's anti-piracy enforcement efforts have been over-aggressive or anti-consumer. Rather, I would suggest your concern should be whether these enforcement efforts may be too little, too late, whether they are adequately supported by Federal law enforcement, and whether the consumer education efforts behind this anti-piracy campaign are sufficient.

Enforcement is valuable for a specific deterrence of bad behavior, but it is perhaps more important as a public education tool. The public needs to clearly understand that so-called, "peer-to-peer sharing" of music is stealing and it is wrong and it will be prosecuted. The public also needs to be aware that several legal alternatives exist for acquiring digital music. We call on the RIAA, Congress, music companies, musicians, and the press to at least match the attention they have given to black market networks with an equal level of attention and support for legal services.

Congress must also do its part. Two years ago, the U.S. Copyright Office reported to Congress suggesting changes in copyright law for digital online music, but neither the House nor the Senate has acted. We urge the Congress to consider these recommendations and to modernize our copyright laws for a digital age.

MusicNow and other legitimate Internet music companies have built great services which offer hundreds of thousands of songs, including new releases and back catalog. Collectively, we have several hundred thousand paying customers who demonstrate that there are viable alternatives to stealing music online.

I believe in the inherent ethics of the American people, and we prove that every day by signing up paying customers. However, in order for the United States to enjoy the benefits of our cultural creators and of a vibrant and healthy digital media industry in the 21st Century, we must establish and enforce property rights for digital media just as we did for manufactured goods in the 20th Century. Thank you.

Senator COLEMAN. Thank you, Mr. Gladwin. Ms. Sullivan.

TESTIMONY OF LORRAINE SULLIVAN,[1] NEW YORK, NEW YORK

Ms. SULLIVAN. Good afternoon, Mr. Chairman and Senators. In August 2003, I was sent a very confusing letter by my cable provider alerting me that they had been subpoenaed by the Recording Industry Association of America for my personal information for copyright infringement. I immediately called the phone numbers listed on the subpoena for the RIAA and the lawyers, but wasn't able to reach anyone. My customer service from the cable provider told me not to worry about the matter, that I would probably just receive a cease and desist order. However, that turned out not to be the case.

On September 9, 2003, I came home to four messages on my answering machine from reporters asking me for statements in response to being sued by the RIAA. After recovering from that shock, I immediately tried to contact the RIAA and the person I reached explained the charges and that they could range between $750 and $150,000 per song. He followed that up saying that the goal of the RIAA was not to ruin your life and make you bankruptcy.

Actually, it felt like that. He said a letter would come with the summons. It would explain how I could settle the case out of court. He said a settlement would be in the low thousands and it would probably be worth it to put it all behind me and get on with my life. He referred me to Pat Benson and advised me not to seek her advice, as she was not my attorney.

I phoned Pat Benson. She told me that if I settled, I would get settlement papers detailing a mutually agreed upon monetary settlement. I then asked the exact number and she quoted between $3,000 and $4,000. She said I probably heard about a 12-year-old who had settled for $2,000, but informed me that that had been a special case, since Brianna's mother was on public assistance. This particularly upset me, because I thought since I worked so hard for many years and waited until my mid-20's to go to college and I am not on public assistance, my case is different. I couldn't understand that implication. I asked if the settlement had to be paid in one lump sum. She said yes, accepting increments would not be feasible.

[1] The prepared statement of Ms. Sullivan appears in the Appendix on page 130.

At this point, I was crying and told her that all I had was $1,500 to my name. I explained that I was already in debt, a full-time student. I also explained I had taken out student loans, but they had almost all gone to my tuition and expenses. She asked me if I could ask my parents for money, to which I replied no. She asked if there was anyone else I could go to and I said no. She asked if I had credit cards at that point. I told her I did, but they were pretty close to their limits, but perhaps I could inquire about cash advances.

I was explaining to her that this was all pretty stressful and she said that nobody likes to be the heavy. She said she would go to her clients to see if they would be willing to accept less than $3,500 from me.

Two days later, she told me that they had accepted the sum of $2,500. I had come up with $2,100 at that point. She told me that the paperwork would be sent out. I would have a week to look it over and send it back with a certified check. I created my website seeking advice or help from the 60 million or so other download users. It helped me raise $600 in donations towards my settlement. I actually received my summons on September 18, 2003, when they were hand-delivered to my address.

I feel that I have been misled as a consumer of music. Particularly misleading is the advertising that Sony has for their minidisks. In the commercial, you see a blue-headed alien encouraging a couple hundred friends to copy the play list he has created. Is it any wonder why other consumers such as me found and actually still continue to find it confusing? I mistakenly imagined that since Kazaa was still up and running, while Napster had been forced to close down, that the downloading I was personally responsible for was OK.

I compared my actions to recorded songs on the radio. As far as I was concerned, the music I downloaded was for home personal use. I in no way financially benefited from nor intended to make a profit from this music. To me, copyright infringement actually pertained to the people in Chinatown who were hawking bootlegged and fake CDs on the street corner.

I have taken responsibility for my part in all this. I fully realize that "I didn't know what I was doing" is certainly not a valid defense. Still, I am very upset with the way that the RIAA, and their unfairness in handling the subpoenas and lawsuits. Where is the due process of law?

I resent the invasion of my privacy, being named publicly without any warning whatsoever and also being unfairly targeted and having to choose between paying a settlement I can barely afford or to deal with the stress of litigation and potentially being held responsible for a couple million dollars in damages.

The RIAA manner of investigating is severely lacking. They may not seem to care how responsible the person listed on the IP address actually is for the crime they are accused of. They go through all the trouble to make press statements, but do not follow up on actually researching how egregious each user is. They could have at least informally gotten in touch with me before knowingly unleashing a media storm upon my head.

Supposedly, though I never actually read one, the RIAA sent out instant messages of warnings to people. This doesn't make sense to me. If I am not the one who is actually on Kazaa at the time, how can they ever be sure it got to me? With all the people who have come and stayed at my apartment, including subletters, roommates, family members that I have had, it would be nearly impossible to monitor everyone and everything, and I wonder why they didn't send a letter in my name to address me personally and make me aware of their intentions. I would have ceased and desisted on the spot. I would have made sure all my household members did the same. Surely, a courteous letter would bring about a much quicker result than a complaint filed in court, but they never gave me that chance to protect my privacy.

I have been a music fan all my life and until recently had still bought CDs of the artists I love because I do wish to support them. But until the RIAA stops targeting unwitting victims, I am not going to buy any more CDs and I know many consumers feel the same. The personal invasion of privacy, the financial punishment and personal stress I have suffered seem a very hefty price to pay.

I settled my lawsuit, gained a whole education of what is really at stake here, and now my main concern is that this situation not happen to other people. It is not fair to anybody not to be duly warned nor to have a chance to answer the charges against them. We need to change the system without creating new victims, and I hope that change starts here.

Senator COLEMAN. Thank you, Ms. Sullivan. Thank you for your courage to come forward today. Mr. D.

TESTIMONY OF CHUCK D, RECORDING ARTIST, AUTHOR, ACTIVIST, LOS ANGELES, CALIFORNIA

Mr. D. Good afternoon. I see there is less of an audience than the first panel. Maybe they are getting their picture taken and autographs.

I repeatedly come to you as an artist, a fan, a father, and a technology buff. I feel that we should go forward, that we want to go forward, that as technology prevails, it giveth and it taketh away, and the industry knows this. The horseshoe makers probably got upset at the train manufacturers because it took away their transport dominance, just as the train manufacturing business probably got mad at the airline industry.

I think this expands artistry and it is about adjustments. And if the Internet reaches the world, then maybe we should think about becoming more worldly, and if P2P reaches the world, we should think the same. We shouldn't just detach ourselves from the planet for the sake of just having American business.

As this pertains to the music, the industry has lost sense of its humbly beginnings while being hypocritical at the same time. The fans have gotten hold of the technology before the industry. Just like once upon a time the photography business thought they could make a killing on the exclusivity, and all of a sudden, portable cameras came out. We still have a viable photography industry. People still take their pictures. They make a living. Maybe they don't make a killing. Maybe that should be the theme of American business.

Companies digitized. Record companies digitized in the late 1970's and the early 1980's and they let the genie out of the bottle then, and they knew it was an unprotected format, digitizing signals and waves so they could raise the prices as hardware and software companies merged. And so it is difficult to define the crime alongside the technological innovations that move faster than the domestic legal corralling of that industry.

I speak at many colleges. They know it is a crumbling economy. Increasing tuition. The college student would rather have Wendy's and lunch than try to buy an expensive CD.

The collusion of five record companies and four radio networks and TV outlets is becoming issues of the FCC, and as it pertains to artists, it stifles the growth of grassroots businesses from the bottom up to the top. I think this is a great way to expose across the planet. I call it a new accessible radio. In fairness, performance fees might have to take place of the mechanical fees that companies and artists seem to think that they miss.

As an artist representing an 80-year period of black musicianship, I never felt that my copyrights were protected anyway. I would sign a contract and my lawyer would tell me, this goes out to the world and the universe. So that means when I get to Venus, why should Universal get the rights when they can't be there themselves? If I could get to the Ukraine with my copyrights, then it should be up to me with my flexible business plan.

I have been spending most of my career ducking lawyers, accountants, business executives who have basically been more blasphemous than file sharing and P2P. I trust the consumer more than I trust the people that have been at the helm of these companies.

I have been told by Universal themselves that, Chuck, you have sold millions of records for us, but you will never receive a dime from us again in lieu of spending money on my behalf and marketing and promotional fees that had to clear the high hurdle that the collusion formed in the first place. So they say it costs money to promote, but they create the standard that costs so much for the artist to get exposure to the marketplace. That is what got me involved with file sharing in the first place. It is controlled and the usual names and suspects want to maintain it.

In all fairness to my friend, L.L. Cool J and Leo Cohen, I was there at rap music and we know the beginnings of it, with the machinery, the turn tables, the drum machines, and the hypocrisy of the contracts and what built the damn thing in the first place is forgotten since some people have become the haves looking at everybody else like they are the have-nots. They used music that was previously copywritten music in the first place to make the music that form the companies that makes this guy sell his company for $160 million. Music was sold and exchanged at swap meets, flea markets. Illegal tapes were sold to build and promote the music in the first place in the 1980's and in the 1990's.

And as far as rock and roll, blues licks were taken from the Mississippi Delta without authorization so people could spend $180 to check out the Rolling Stones do it all over again. So the record industry is hypocritical and the domination has to be shared.

P2P to me means power to the people, and let us get this to a balance, and that is what we are talking about.

Senator COLEMAN. Thank you, Mr. D.

I am going to come back in reverse order and come right back to you, Mr. D. I asked L.L. Cool J about the new artist, somebody coming up. You have the recording industry and you have technology that is offering these new opportunities out there, but at some risk. What advice do you give somebody coming up?

Mr. D. To learn all of the above, to at least have control of their business model and make sure it is flexible, and to be able to use these exposures to the best of their ability. You have to reach the fans, and in the businesses in both film and music have gotten away from the people. I mean, people wouldn't use it if it wasn't out there in the first place. When it comes down to it, blank CDs—CDs are still selling. They are just blank.

And it all brings us back to the table. This is the same bullet and gun as the K–Mart argument. Best Buy sells computers and blank CDs. So the consumers come in and say, wow, this is a technology that the music business and the film industry did not come up with in the first place. We came up with it. What do you expect them to do?

Senator COLEMAN. What about the artist who is taking the other path? Don't they have a right to do that and don't they stand to lose?

Mr. D. What other path?

Senator COLEMAN. The path of saying, I am working with a recording company. This is the way I am going. I have got a copyright. I produced something. I should get paid for that.

Mr. D. If there was honesty in that neo-plantationistic attitude of a company telling the artist exactly, like you signed a worldwide contract, but we can't sell CDs in Africa. We can't sell CDs in the Ukraine. Then it should just be a domestic contract. The problem is, is that the lawyer that negotiates for the artist many times is on the same side as the record company and they flip back and forth. So the artist never, ever knows the truth. So their trust in the companies has been defaulted for the last 80 years anyway. What other choice for innovative artists do we have?

And what other choice does a new artist—I will tell you what is going on, because it is also combined with the FCC. If an artist comes out of Phoenix and wants to get played on Phoenix radio, they have got to get signed by the major companies in order to get played back in Phoenix to their demographic. That is crazy.

Senator COLEMAN. Thank you, Mr. D.

Ms. Sullivan, when you were first notified that you were being sued and you had a conversation with the folks from the RIAA, or at least directed to them, and you were told there was a potential of a $150,000 penalty, what did you feel?

Ms. SULLIVAN. I was horrified, because the first thing I thought of was, well, that is it. My life is over. I will have to file bankruptcy. I won't be able to get a house. I mean, those were the fears that immediately came into my mind.

Senator COLEMAN. Before this, you talked a little bit about Napster and that it is gone, and that Kazaa is still there. You figured this may be legal. You go into the store and you see the CDs

that are available. Had you seen anything from the RIAA, anything from the recording industry about the evils of downloading?

Ms. SULLIVAN. No, I haven't, but I don't watch a lot of television. I listen to CDs that I buy. I don't really listen to the radio. So no, I really hadn't seen anything that they had put out there, I guess.

Senator COLEMAN. What do your friends say now? How did they react? Do you know folks who still download, and have they been moved one way or the other?

Ms. SULLIVAN. Not my close friends and family. As soon as I told them, they all immediately put a stop to what they were doing, and most of them feel the same way I do, which is that they don't want to buy CDs anymore. They feel like this is so unfair, that until it changes we are not going to keep buying the music or the product.

Senator COLEMAN. Thank you, and again, thank you for your courage in coming forward.

This question, I am going to put to all three of the gentlemen there. I am trying to understand whether this thing is solvable, whether, in fact, you can work with the recording industry to approach a workable solution. I got a sense from Mr. Gladwin saying, yes, I am going to work with the industry. We have got that worked out. Mr. Broes and Mr. Morris, you have got a different perspective.

Can you help me understand the division here? What is missing, and in your own words, why is it easier for Mr. Gladwin to do what he is doing, but Mr. Broes and Mr. Morris, you still see some difficulty in reaching that workable solution.

Mr. BROES. Well, I think that there are two issues here. There is about commercializing the Internet from a film and a music industry point of view. This is about maintaining their existing relationships and distribution channels. I understand that is a very delicate balance. They have to maintain their relationships with Best Buy and they have to appease those and I understand that.

But we also have an issue of peer-to-peer networks and it is precisely why I got involved in it in the first place. I was hired to investigate peer-to-peer networks on behalf of the RIAA and the MPAA. In fact, I was hired to investigate Kazaa, which I did. When I saw the technology, I saw how powerful it was, I encouraged them to exploit that technology, and the approach, the only solution from a technology standpoint that I saw was commercializing that in the same way that Yahoo and Google has commercialized their search results.

When you type in "Tom Cruise," you get 20,000 sites that were essentially pirating Tom Cruise's name, and they would be pornography sites and such. They started selling those search results and pushing those illigal results deeper. They are still there, and they are still as illegal as they ever were, but they are just very difficult to get to.

And so as far as from a technology standpoint, the solution is commercializing peer-to-peer networks. It is not colluding with the enemy, and that has been our goal from day one.

Mr. GLADWIN. With all due respect, I think there is some misunderstanding of what the real issue is. The real issue is not peer-to-peer technology. We have technology that we actually think is better than peer-to-peer. There are other companies like us that

offer licensed, legitimate digital music on the Internet that have similar approaches.

We don't have a problem figuring out how to distribute hundreds of thousands or tens of millions of legal songs. That is not the problem that the industry is looking for a solution for. The issue here is copyright law and compensating owners for their works.

FullAudio and similar companies approached the music industry and said, look, we would like to work out an arrangement where we fairly compensate owners and copyright owners. And by taking that approach, we have been able to get those licenses.

Mr. MORRIS. You talked about paradox. Derek is responsible for negotiations in the USA and I am responsible for negotiations in the rest of the world, and we have companies in India's "Bollywood," a major distributor of films outside the United States. We have independent artists and companies in the UK. We have 30,000 emerging artists.

You asked Chuck D how should a new artist go. Thirty-thousand emerging bands have distributed license content through Altnet. You can go to Altnet and for $99 you can distribute your content in a licensed way on KMD. That is how easy it is to do it. So the paradox I have is when everybody else recognizes—and I think it is reasonable to presume, also, that, as Derek said, many people in Hollywood recognize that this is the best method in terms of efficiencies and in terms of being a chosen method for distributing.

Why won't they license the content? I know it is hard to negotiate. We have no difficulty with that; we were set up to do that. There has got to be another reason, and people have always said this is probably about control.

Senator COLEMAN. Thank you, Mr. Morris.

Senator Pryor, you have been here. I am going to recogize the presence of the distinguished Ranking Member, but I will defer to you for your questions first.

Senator PRYOR. Go ahead.

Senator LEVIN. You have been here consistently. You go ahead.

Senator PRYOR. All right. Well, let me run through my questions because I certainly want to hear from Senator Levin, as well. He always has great questions.

Mr. Morris, you mentioned a couple of times, I believe, in your statement and in answering questions that this is, at least today, the most efficient and effective way to distribute music. Tell me about your traffic count, so to speak. Are you increasing or decreasing in the number of people who are using your site?

Mr. MORRIS. Are you talking about in the last month or two?

Senator PRYOR. Yes, just in the last, say, 6 months or so.

Mr. MORRIS. Data would indicate that there has been the normal seasonal drop. As I say, I used to run a TV company. We all know what happens in the summer, and there was a drop at the beginning of the holiday period; there always is. It looks as though it is coming back, so we don't see significant reductions or changes other than those we would expect.

Given, also, that the growth of P2P has been nearly exponential over the last 3 years, even though I am a statistician by background, projecting what it would be this year isn't a perfect science.

But it doesn't look as though there has been a massive reduction. That is my best guess.

Senator PRYOR. You seem to be kind of on track with where you thought you might be? Is that fair?

Mr. MORRIS. Well, we might be in terms of number of instances of the application downloaded, yes; in terms of the critical mass of users, yes; in terms of having licenses so that those users can access the content they want, no.

Senator PRYOR. I am not as familiar with your site as maybe I should be, but when someone comes on your site, they have different choices. One thing they can do is they can download your software. Is that right?

Mr. MORRIS. Yes. I will very briefly talk you through it. People are referred by friends or they go on to one of the portal sites or whatever. If they go to CNET Download, which is one of the major sources, they will be given the option of downloading. The applicaiton will be described in a standard way in terms of size, etc. The application is downloaded. There is a very full disclosure then, and as I testified at another place in this building, we work very hard to make sure that it is very difficult for anybody to share that which they don't wish to share.

So all the defaults are set basically with big yellow signs saying "Do you want to share this?" So the application is then installed on the computer in the way in which any application would be, and then it is used. So the site is purely a way by which people obtain the application.

Senator PRYOR. Now, that application you are talking about—is that software that you have created?

Mr. MORRIS. There are two aspects to the software. One is the underlying protocol. Just as HTTP is the protocol used on the Internet, there is a peer-to-peer protocol, and we have the graphic user interface which plugs onto that. So we have acquired that. The user interface is ours.

Senator PRYOR. Now, is that software that you have copyrighted or protected in some way?

Mr. MORRIS. It is, indeed.

Senator PRYOR. Let me ask you this question. Does anyone pay for music on your site?

Mr. MORRIS. Yes.

Senator PRYOR. OK, and how does that work?

Mr. MORRIS. That works through Altnet.

Senator PRYOR. Some do, some don't, or is that by the artist, or how do you know?

Mr. MORRIS. The Altnet mechanism—and I will just explain it very briefly, if I may—is that when somebody searches for content and there is a DRM-protected and licensed file, that file, as Derek says, will be displayed first. The content owner then has complete control over the terms under which that file is then licensed.

They may well say somebody can play it for 3 days. They may well say you have to pay straightaway. They may well say this is promotional. I should say that the upcoming software release—the things that we are doing in terms of making it even more creative and more effective for users are increasing even more.

So that file has allowed the content owner, in negotiation with Altnet, to set their own terms. If you go to the Altnet site, you can actually do a click-through. For $99, you can put your own material up there, and it will say what level of security do you want, what licenses do you want, etc.

The important issue, of course, is—and this is where the efficiency of P2P comes in—that gold file sits in somebody's shared folder and we have a program with Altnet which encourages, like a frequent-flyer program, the sharing of these gold files, something which Altnet funds.

If somebody then searches that file and finds it from a peer and downloads it, that file is still protected. The DRM still works. So that file will again go back to the DRM server and say what are the terms for me to see this? That is why P2P is so efficient. Instead of downloading each one each time, the distribution is dealt with by the network.

Senator PRYOR. Well, they are downloading it each time, but are they paying for it each time?

Mr. MORRIS. Yes, they are.

Senator PRYOR. Can you tell us how that works?

Mr. BROES. They pay through a payment gateway that we have provided, so I will give you just a very basic scenario. If you download one of our files or you type in an artist's name, you double-click the file and you download it. When you open that to play, a window will pop up and say, this is the artist, and say it is 99 cents or 49 cents, or whatever the price that the content owner has set.

You enter your credit card, or we have other systems that allow you to receive a telephone call. It will be a recording of the artist on the line saying thanks for downloading my product, press 1 to confirm your purchase. The license is acquired. Now, that file is free for them to play.

In the interest of paying, I think it is important to note that we are distributing close to 35 million licenses of legal content, of licensed content, every single month, and that is without having the major labels' content. We also do this for the game industry, as well, and do the same function for software. We distribute up to 30,000 licensed games right now, including many games from some of the major gaming companies like Atari.

They understand how this mechanism works and they are ecstatic that they can provide the game on our company's peer-to-peer network in the same fashion that they do in the stores, but without having to pay for the packaging and the wrapping, and they sell it. These are big files; these are one-gigabyte files and they sell for $50, and people put their credit cards across the line. And let's keep in mind, I am also competing with free. So if I can compete with free and succeed, then the industry certainly can.

Senator PRYOR. But are you saying that every single person that accesses your site is actually paying in some way or is entering into a licensing agreement in some way with musicians?

Mr. BROES. There is a choice that individuals make. When they see a gold file, they choose to purchase it. When they download that gold file, they choose to purchase that file.

Senator PRYOR. Yes, but is every single person doing that?

Mr. BROES. Well, if every single person were doing that, I would be distributing more than 35 million files a month. Let me put it this way: If I can put the industry's content—if the labels licensed me their content as they have licensed iTunes and BuyMusic.com—if they license me that music and I put it into the system in a secure fashion, I guarantee you that every single one of those users will purchase those files. Some won't, and maybe then that is the time for the stick approach. We are saying that there is a carrot-and-stick approach for the solution.

Senator PRYOR. That is all I have, Mr. Chairman. Thank you.

Senator COLEMAN. Thank you, Senator Pryor. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

First, a question for Mr. Gladwin. I am trying to understand some of the technology, also, here. Is it technologically possible for a software developer to include in online software the capacity to block a person who has downloaded the software from subsequently using it, like a turn-off switch?

Mr. GLADWIN. Yes. That is not only technically possible, but it is standard industry practice. There have been a number of instances where AOL, Prodigy, and other services 5 or 10 years ago started that practice.

Senator LEVIN. Now, Mr. Morris, let me ask you whether or not your company can cut off people who are violating your end user agreement's prohibition against downloading copyrighted material.

Mr. MORRIS. We have no knowledge and control over users, in the same way that Microsoft doesn't know who has a copy of Outlook or whatever. So, technically, it isn't possible.

Senator LEVIN. So you disagree with Mr. Gladwin's answer?

Mr. MORRIS. Yes.

Mr. BROES. I would like to add a piece of this, because prior to Altnet I was the CEO of Vidius, which I said had done some work for the MPAA and the RIAA on peer-to-peer, specifically Kazaa. We practiced interdiction. We invented many of the technologies that they use today—interdiction, blocking the files. We also were involved in spoofing files, putting files out there to try to disguise them in certain ways.

What I found was it is not impossible. It is certainly possible from an outsider's standpoint, when you can recognize someone sharing. The difference is we have a real issue identifying, without question, that the file that they have is specifically the one—for instance, I don't want some 15-year-old or some 12-year-old boy to make a movie in his backyard called "Gladiator" and I start interdicting and blocking that file because of the name, that it is called "Gladiator." So the process to verify those files is very extensive and it is not cost-effective when you are looking at trying to prevent the piracy.

Senator LEVIN. You have the ability to do it, though?

Mr. BROES. Do we have the ability?

Senator LEVIN. Technologically, the ability is there?

Mr. BROES. Sure. The ISP can shut down that individual user if you notify them. Of course, they can.

Senator LEVIN. Do you disagree with Mr. Morris' answer that they cannot technologically do that?

Mr. MORRIS. I think we are answering two different questions.

Senator LEVIN. Well, I asked a question of Mr. Gladwin and he answered the question yes. I asked the same question of you and you answered no. So I tried to ask the same question.

Mr. MORRIS. My understanding of your question, Senator, is you asked, if a person had downloaded the Kazaa Media Desktop application—that having happened, was there any way in which we could technically stop that person from using the application.

Derek, you would agree that that is impossible?

Mr. BROES. Yes.

Mr. MORRIS. I think you are answering a slightly different question.

Mr. BROES. Yes. I was answering the question, is interdiction possible.

Senator LEVIN. Here is my question. I will repeat it. Is it technologically possible for a software developer to include in online software the capacity to block a person who has downloaded the software from subsequently using it, like a turn-off switch? Mr. Gladwin's answer was yes.

Your answer, Mr. Morris?

Mr. MORRIS. No.

Senator LEVIN. Now, it is the same question, Mr. Broes. So we don't have a problem of answering different questions. We have a problem of answering the same question the opposite way. I don't want to argue which is correct.

Mr. BROES. Sure, I understand.

Senator LEVIN. But in any event, if you could have that capability, would you use it, Mr. Morris?

Mr. MORRIS. That is a hypothetical question.

Senator LEVIN. It sure is.

Mr. MORRIS. I mean, first, we don't. Second, to Derek's point, I think that there is a myth around that somehow you can identify what a file is. There are many promotional files out there. There are files that are misnamed. The provenance of a file is very difficult to identify.

So there are two problems in my answering your question. First, could we be certain that people were infringing? Second, could we switch them off? And the answer to both is no.

Senator LEVIN. So you would not use that technology even if it were technologically possible?

Mr. MORRIS. If it were technologically possible, which is bounded by the laws of physics rather than anything else, then in answer to the first question, I don't know if we would use because we would have to be certain if we were to use it that the files could actually be identified. So I can't answer the question, sir.

Senator LEVIN. How do you enforce your prohibition that is in your agreement against users infringing on copyrights?

Mr. MORRIS. My understanding—and you must know I am not an attorney—is that EULA, which is pretty standard——

Senator LEVIN. That what?

Mr. MORRIS. Yes. EULA, the end user license agreement—sorry I slipped into jargon there—is a permissive one. What it says—this is the interpretation of our attorneys—is that if people carry out the permitted acts, then they are licensed. They are not licensed when they carry out non-permitted acts. So it isn't a matter of re-

voking the license. The license doesn't exist if they carry out prohibited acts.

Senator LEVIN. Let me read you your agreement, your EULA. "Your rights under this license will terminate immediately and without prior notice if you violated any terms of this license. . . ." It sounds to me like it is going to terminate, which is not what you just described.

Mr. MORRIS. I am advised by our attorneys—and I don't know, Senator, if you are an attorney.

Senator LEVIN. Well, I am an attorney, but I also am just reading your agreement. I mean, the fact that I am an attorney isn't relevant to my question. The agreement is very clear that the agreement will terminate. "Your rights under this license will terminate immediately and without prior notice if you violate any terms of this license, including violating any applicable laws or rights of any third party, including the intellectual property rights of any such third party," which is very different from what you just said.

Mr. MORRIS. These honor agreements are common.

Senator LEVIN. These what?

Mr. MORRIS. Honor agreements.

Senator LEVIN. This isn't a real agreement? This is an honor agreement?

Mr. MORRIS. These are honor agreements.

Senator LEVIN. Which means——

Mr. MORRIS. They are common throughout the Internet. They are click-wrap agreements. Because we don't know who the users are, because we can't technically control them, they are called honor agreements.

Senator LEVIN. Which means they are not worth the paper they are written on?

Mr. MORRIS. I wouldn't say that, sir.

Senator LEVIN. Well, what would you say if they are honor agreements?

Mr. MORRIS. I would say that honor is respected.

Senator LEVIN. They are not enforceable, though?

Mr. MORRIS. It is not enforceable. I don't believe that because something is not enforceable, it shouldn't be set down.

Senator LEVIN. If you had the power to enforce it, would you?

Mr. MORRIS. So what you are saying, if I may paraphrase, is if a court of due competence judged that somebody was in breach of a law or an obligation—Is this what you are saying?

Senator LEVIN. No. I am asking a question. If you could enforce it, would you?

Mr. MORRIS. If we could enforce it, would we? My answer is if the court of due competence stated that there had been an infringement, then we would certainly look at it.

Senator LEVIN. My time is up. Thanks.

Senator COLEMAN. I want to follow up with a couple-minute follow-up. I sense that there are some follow-up questions that Subcommittee Members would like to ask.

Mr. Morris, let me raise the question with you about notifying users that copyrighted material is illegal. One of the concerns that

has been raised is when one goes on Kazaa, the notice that this is illegal is not prominently displayed.

Is there a reason why you wouldn't want to more prominently display that? Is there any thought about doing that?

Mr. MORRIS. As I said, when we acquired www.kazaa.com and the Kazaa Media Desktop, the first thing we did was to take it all offline, strip it down, change the EULA to which your colleagues refers, and put in those prominent notices.

You are saying, could they be larger? I suspect that there is a debate with designers about how large something has to be. We would certainly consider making it more prominent if that will be beneficial, but there is no magic in the size.

Senator COLEMAN. Mr. Broes, do you want to respond?

Mr. BROES. Yes. I think I can do one better than just notifying those users. I would like that when they type in "Eminem" to find licensed songs that they can purchase from Eminem, and to replace that and let them know right away that this is a legal file and displace all those illegal files. I think that is more powerful than you are doing the wrong thing.

Senator COLEMAN. We are getting to whether we can get long-term solutions here, which is licensed material online.

Mr. BROES. Yes, absolutely.

Senator COLEMAN. And let me ask just one other kind of technical question. Mr. Morris, apparently there are updated versions of Kazaa, which I think are actually better in terms of identifying this stuff. But I have been told that penetration is still pretty light, that folks aren't transferring over. How do you get folks to transfer over to an updated version? What kind of penetration do you have?

Mr. MORRIS. Again, because we don't know specifically, it is anecdotal, but the evidence seems to be from our technical director that over a relatively short space of time—we are only talking about months—that about 90 percent of people will upgrade. The reason the application is so popular is that we worked very hard on it. It is smooth. It works very well. We put a lot of features in there. And particularly since the relationship with Altnet, by including things like the channels—there is a hip-hop channel, the emerging artist channel, which I mentioned—there are major incentives to people to upgrade.

So we can't make people upgrade, but all the evidence suggests that, over a relatively short space of time, most do. Some will not, because some people always stick with what they are with, but over time, that tends to be a small proportion.

Senator COLEMAN. Great. Thank you. Senator Pryor.

Senator PRYOR. Mr. Chairman, if it is OK, I would like to allow Senator Levin to proceed with his questions and his follow-ups and I may have a few follow-ups after that.

Senator COLEMAN. Senator Levin.

Senator LEVIN. I am just curious about—we are trying to find out more about your company. It is normal for most companies and corporations that are incorporated in the United States, for us to get a feel as to who these folks are and it is public information. You are incorporated, or your parent is incorporated in Vanuatu?

Mr. MORRIS. Indeed, yes.

Senator LEVIN. We have got a lot of experience with that particular jurisdiction, not particularly positive. When I say "we," I mean the Subcommittee. It is a very secretive jurisdiction, incorporates companies within 24 hours of request. It allows companies to set up websites to conduct business without requiring residency, directors, shareholders, or a registered office in the country, according to our State Department. It has been named by our State Department as a country of money laundering concern—that is a State Department issue—due to the excessive secrecy laws, weak anti-money laundering enforcement, other problems. It licenses offshore shell banks.

This is a problem with Vanuatu that we have had as we have gone through some investigations. It characterizes itself as a tax haven, one of seven countries on an international list up until a few months ago of uncooperative tax havens. It has been removed from that list after promising to increase transparency.

I am just curious why you are incorporated there. What is your—I am trying to figure out who owns your company. Most of that information should be public, if it were an American corporation, but why Vanuatu?

Mr. MORRIS. I think there is a perception in the States—this is my observation—that offshore is somehow something——

Senator LEVIN. No, Vanuatu specifically. Why Vanuatu?

Mr. MORRIS. Because it is the closest island to Australia and that is where we are——

Senator LEVIN. Why not Australia?

Mr. MORRIS. We are registered in Australia. The service company is registered in Australia.

Senator LEVIN. Your parent company, the beneficiaries, the trust, the owners could be——

Mr. MORRIS. No, that is incorporated in Vanuatu.

Senator LEVIN. Why not Australia?

Mr. MORRIS. Sir, the same reason that major banks, media companies, and others are—Australian companies are incorporated in Vanuatu, for tax savings.

Senator LEVIN. They are tax havens.

Mr. MORRIS. Yes.

Senator LEVIN. Are you——

Mr. MORRIS. Major banks, major companies do exactly the same thing. It is a much more common thing than it is in the States. It is the same way that people register in Delaware.

Senator LEVIN. Are you able or willing to share with us the ownership of your company, your parent company?

Mr. MORRIS. The ownership of the company is a matter of record in Federal deposition.

Senator LEVIN. The trust beneficiaries who truly own the company, is that a matter of public record?

Mr. MORRIS. Sir, it is a matter of record in deposition. I am not an owner or shareholder of that company, so I cannot speak on behalf of the company.

Senator LEVIN. The information you make reference to in depositions is under seal. Would you be willing to make that public?

Mr. MORRIS. Without advice, I can't do that. This is a subject——

Senator LEVIN. Would you let us know?

Mr. MORRIS. It is a subject of litigation, as you know, by a particularly aggressive foe, so I would need to take advisement.

Senator LEVIN. Would you let the Subcommittee know whether you would be willing to do that, for the record?

Mr. MORRIS. Yes, certainly. I will liaise with the relevant staff.

Senator LEVIN. And the balance of my questions, I will save for the record in light of the time. Thank you, Mr. Chairman. I thank all of our witnesses.

Senator COLEMAN. Thanks, Senator Levin. The panel is excused. Thank you very much.

Senator COLEMAN. The final panel is Dr. Jonathan D. Moreno, Director of the Center for Biomedical Ethics, University of Virginia, Charlottesville, Virginia, and James DeLong, Senior Fellow and Director, Center for the Study of Digital Property, The Progress and Freedom Foundation in Washington.

Pursuant to Rule VI, all witnesses before the Subcommittee are required to be sworn, and gentlemen, will you please stand. I ask you to raise your right hand and repeat after me.

Do you swear the testimony you give before the Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. MORENO. I do.

Mr. DELONG. I do.

Senator COLEMAN. Thank you. You can sit down.

There are no rock stars at this panel, but the discussion, I am sure, will be very worthwhile.

Mr. Moreno, it is a pleasure to see you. You may proceed.

TESTIMONY OF JONATHAN D. MORENO,[1] DIRECTOR, CENTER FOR BIOMEDICAL ETHICS, UNIVERSITY OF VIRGINIA, CHARLOTTESVILLE, VIRGINIA

Mr. MORENO. Thank you, Senator. Good to see you. This has been a fascinating colloquy this morning. I spend most of my time worrying about matters of life and death and the paradoxes and contradictions of taking care of people under extreme circumstances when moral values are in conflict. Although this is not specifically perhaps a matter of life and death, it is obviously of grave concern to people who make their living.

I am reminded, in thinking about analogies for the ways in which ethical change is created by technological change, of my mother's situation 46 years ago. My mother was diagnosed with a chondrosarcoma when she was in her late 40's. Her arm was amputated. She lives to this day, I am happy to say. She is 86 years old. But she was not told her prognosis by her doctor, and that was very common 50 years ago for cancer patients not to be told their prognosis.

As the technology changed and we began to have more control over the course of a disease, the consumer, the patient, insisted on having control over information. So we have an interesting analogy here of the way that in health care, technological change has created moral change. Fifty years ago, it was thought that doctors

[1] The prepared statement of Mr. Moreno appears in the Appendix on page 134.

would be unethical to tell a cancer patient their prognosis. Today, we clearly don't feel that is the case, and just the opposite.

Having said that, today, I come before you not as a bioethicist but as a social ethicist. In one sense, the question before us in social ethics is straightforward. As has been said this morning, to intentionally take that which does not belong to you is to violate the social contract. Intellectual property is a form of property and intellectual theft is a form of theft.

Yet if our goal is not merely to be punitive but to craft an effective public policy, as we know, the law is a notoriously blunt instrument. There are many social behaviors in which the rigid application of the law is not only ineffective in solving the underlying problem, but may actually aggravate the problem by encouraging offenders to find ingenious new ways to use technology, in this case, to evade authorities or decrease their buying of legitimate CDs.

Prosecution may also be disproportionate to the value of its loss, up to $150,000 in fines in this case. It may be seemingly arbitrary in its selection of targets. Making an example of a few people for the sake of deterrence makes many Americans uncomfortable. Or the prosecution may be erroneous. Files may be misidentified by ISPs.

Furthermore, if powerful and distant entities that control a highly-valued item, like music, institute legal measures that are widely perceived as draconian, they may encourage disrespect for law, especially among young people. Still more complex situations like this in which the culture itself is evolving in tandem with technological change.

Here is the underlying problem. Many people with otherwise healthy moral intuitions fail to see Internet file sharing as theft, or if they do, they do not perceive it as wrong, or at least not very wrong. I have spoken to a lot of my students about this in the last few days and I can tell you this is the case.

The lawsuits themselves may not, in fact, send a moral message. They may teach people that this is theft, but they may not teach them that it is wrong. And it may not teach them—the lawsuits may not teach them that this is not worth the risk of prosecution.

Of course, we have heard that the pricing structure of compact disks is widely resented because the blank CD is so inexpensive. I went to Office Depot yesterday and I looked at blank CDs for 50 cents or less. And downloading can be accomplished with ease. But these facts don't explain the moral psychology underlying this phenomenon. What is the psychology of guilt-free file sharers when they know that it is theft and when these are not evil people?

I think there are a number of explanations. First, and this is a complex phenomenon, those who are victimized are moral strangers. They are not known to us. They are distant. They are unknown to us as individuals. The engineer, the janitor in the factory, the studio musician, the record store clerk, they are not known to us. Harms to moral strangers don't easily excite our guilt.

Second, consumers have become accustomed to the portability and transferability of music, partly because of successful marketing by the industry.

Third, as someone alluded to, unlike familiar forms of copying a record, as in the case of bootleg audio tapes, a copy never needs to be a physical object. It doesn't need even to be put on a CD but can remain in electronic form. Physical associations with theft may be absent.

Now, the very term file sharing, fourth, file sharing is an interesting term. It connotes altruism and community. In particular, many adolescents find a sense of community more easily in the World Wide Web than in the rest of their lives. In this case, what seems to be an impersonal, wealthy, and imperious industry places itself in opposition to this otherwise positive value.

Now, these factors don't justify theft. File sharing, though, is misunderstood as simply an attack on a concept of private property. It is primarily a demand for access to a highly-valued social commodity, a demand triggered and facilitated by technology.

A new interpretation of the social contract in this area, Mr. Chairman, may be emerging, and industry and the law must take note. Thank you.

Senator COLEMAN. Thank you, Mr. Moreno, and Mr. Moreno, your full statement will be entered into the record without objection. Thank you. Mr. DeLong.

TESTIMONY OF JAMES V. DeLONG,[1] SENIOR FELLOW AND DIRECTOR, CENTER FOR THE STUDY OF DIGITAL PROPERTY, THE PROGRESS AND FREEDOM FOUNDATION, WASHINGTON, DC

Mr. DELONG. Thank you, Senator. It is a pleasure to be here today, particularly with Dr. Moreno, because I think the ethical dimensions of this whole issue are absolutely fascinating, and endless, I might add.

I would like to emphasize just one point here, and that is that this is a class of problems called prisoner's dilemma, in which, obviously, the interest of each individual consumer is in free-riding and getting music for free. But, equally obviously, everyone cannot free-ride and get music for free. And so the collective interest is in having functioning markets, functioning property rights that deliver the music and other intellectual products as efficiently and as cheaply as possible.

Now, there is a tension between those two because everyone, in pursuing their individual interest of getting it for free, then tends to destroy the social system. We have all sorts of ways of compensating for prisoner's dilemma problems. The social contract analogy was used by Dr. Moreno, and I think that is very applicable. And what we use primarily are markets and property rights and then some enforcement as a way of doing this.

But this highlights, I think, a fundamental point, and that is a great deal of what I read somehow seems to assume that there is a conflict here between producers and consumers and that consumers have some right to get things for free and that in some way, when you make them pay, you are inhibiting their interests. It isn't so. My interest as a consumer is in making my voice, my

[1] The prepared statement of Mr. DeLong with an attachment appears in the Appendix on page 136.

pocketbook, felt in the marketplace in buying things and in giving the incentives to producers to actually make the things that I want to buy. If I don't have any way of buying something, of actually giving money to the producers for it, obviously they don't do it, and you and I do without.

So at the moment, what is going on is that we have this huge backlog of music that can be looted because it is already there. But if you think about it in terms of not even very long—in terms simply of a couple of years down the road, it is rather obvious this can't go on very long because there will no longer be the production.

Starting from there, it is fairly clear where we want to get on this. The difficulty is in figuring out how to get there and the outlines of a solution.

There must be legitimate online services that wring the unnecessary transaction costs out of the deal. You can send bits over fiber optic cable very cheaply. It is much more expensive to put them on plastic and send them around the country by truck. So inevitably, the prices have to come down, legitimate services have to be there, and the people have to perceive it as being fair.

If I were a student and a downloader, I might well take the position that it was up to the industry to get these services online. Once they did get them online, I would be glad to pay for it. Until that time, there is this firehose of stuff going by and I am going to drink from it. That is exactly the attitude of some college students I have talked to, mostly children of acquaintances and such.

This is both good news and bad news. They can be brought around to a paid system, once it is there, and they can see their ethical obligation to support the industry. Some of them, in fact, even make a point of downloading some things and then going out and buying some CDs to sort of make the moral balance proper.

The second thing, there must be digital rights management control over the downloading so that you can allow people to pay for different levels of use, so people can pay for a single use, multi use, or put it in their library.

There has to be education, not just in the form of saying downloading is wrong, but education in the form of saying, that this whole system depends on the market and on reciprocity. I know I am showing my age, but I remember when you could walk down the street in Boston or Chicago, walk by a newsstand, and there would be a pile of newspapers with a cigar box on it. You took a paper, tossed your money in, and then eventually the operator would come around and pick up the money. I haven't seen that in some time. That is a form of social reciprocity that works, or did work.

And then, finally, there has got to be some enforcement, and I know the RIAA people here are obviously not happy with what they have been forced into, but they have to do it to send a message to the downloaders, to send a message to people who want to invest in the legitimate services, and also to disrupt the system. They are trying to get the downloaders to get themselves into a position where they are willing to download but not upload, because that will destroy the system. If people think, well, I will take, but not give, it won't last very long.

So I think the solution is in prospect, but it may take some time and pain to get there and I certainly hope this body helps us do it. Thank you.

Senator COLEMAN. Thank you, Mr. DeLong.

I actually would have hoped that this panel may have preceded the other panels. It is, I think for me, very worthwhile to hear what I am hearing, which is that in the long run, we can work it out, there is a solution here. Our challenge, it appears to be, in the short run, is whether the strategies being employed or strategies in effect generate any change in behavior.

One of the witnesses talked about the dark net and there are other variations of technology that could push this stuff further and further away. I am a parent and I have a 17-year-old and a 13-year-old and it is a place I don't want them to go, so how do we deal with that?

So the question that remains is certainly the short term. Let me just kind of throw it out to both of you. One of the witnesses, Lorraine who is the subject of a subpoena and a suit, talked about facing $150,000—someone telling her, you can face a $150,000 penalty. I presume that has got to be pretty daunting to somebody who is struggling to make ends meet. Understanding the RIAA had to do something, and I think, by the way, they got great benefit out of this discussion. A lot of discussion. A lot of people who knew before, or who may not have known at all—know now that there is a problem.

But I still worry about that kind of heavy hand—that penalty sitting out there. How do lawmakers try to figure out what is the right balance? How do we, sitting up here—I don't know whether it is $150 a song, or $150,000. Is there a way to get a better sense of what kind of balance, what kind of authority can you give somebody to enforce their interests but not let it be too heavy-handed?

Mr. MORENO. Well, I think that a psychologist would probably tell you that you don't need a $150,000 threat in this case to give somebody a disincentive. You can get just as much bang for your buck, as it were, with a lot less bucks involved. So there probably is some recrafting of the law, the copyright law, required for this kind of situation. My guess is, again, that much of it—this is a disincentive that is really horrifying and it seems to strike fear into the heart of anybody that thinks about it and just seems to be way out of proportion.

Senator COLEMAN. Mr. DeLong.

Mr. DELONG. Yes. I think, clearly, the lack of proportionality is a problem and the penalty was set for other circumstances than this. It was set for people engaging in mass piracy.

Senator COLEMAN. Right.

Mr. DELONG. But I notice that there has been a scaling down by the RIAA itself, and I think certainly by the courts. They figure they aren't going to get anything except—I think what Mitch Bainwol said was the price of the CD.

I might add, generally, there has been a huge increase in criminalization in this country, just one offense after another made into very hefty criminal penalties, and I think this is something, in general, that this body should look at very closely. It is getting to be a severe problem in a number of areas.

Mr. MORENO. Can I add, Senator, also, that there was a little discussion earlier about the carrot approach as well as the stick. It strikes me, as a consumer, I have only seen one instance in which one of these public service announcements was used, and it was in a movie theater about a couple of weeks ago with my wife, I saw it.

Mr. DELONG. Yes.

Mr. MORENO. It was pretty effective. They had a recording engineer who said, "I am a working guy and I am afraid of losing my job." But I haven't seen the industry use its ingenuity and its resources that it uses to sell its products and develop them in the same way to create this public education campaign. I just haven't seen it.

Senator COLEMAN. Do you think that kind of public education campaign can be effective when you have a generation of kids who don't think that they are doing anything wrong?

Mr. MORENO. Yes.

Senator COLEMAN. I am trying to get into the mindset of that 13-year-old, or think that—and maybe it is not—you made a distinction, I have got to get it, between—what was it——

Mr. MORENO. Realizing it is theft but not thinking it is wrong?

Senator COLEMAN. Right. Help me understand that.

Mr. MORENO. Well——

Senator COLEMAN. And in understanding that, talk to me then about things that would actually flip the switch that says, hey, I shouldn't be doing what I am doing.

Mr. MORENO. I think the key is the concept of the moral stranger. The recording engineer, I thought was pretty effective, a regular guy. But what about the recording engineer's 13-year-old? What if you put the recording engineer's child on the screen—and this kid said, "My dad came home the other day and said he might lose his job because my friends in school are downloading and file sharing." That would be a very powerful message, and I am sure it is happening.

But I think, somehow, we have to use these images to make a connection, a living connection, to the experience of people who are affected, not the industry CEOs and the rock stars, but the actual folks. I think the industry is smart enough and creative enough to do this, but I think they haven't done it yet.

Mr. DELONG. I think, also, you see a tremendous amount of demonization of the movie industry and the recording industry in particular. As far as I know, they are just normal, good, greedy American industries trying to make money and have fun at the same time, and they are no worse or better than anybody else, or than any other institution.

But it is like there has been almost—the academic left is a bit opposed to property rights generally, including intellectual property rights, and it is like there is an effort to give people license to rip these people off because they are nasty people and, therefore, go ahead. It seems to me that in educating if you can get across this point that you are injuring your fellow consumers by not doing your share, because you are not helping to pay for this and not helping to produce it, that is an important educational message.

Senator COLEMAN. But, Dr. Moreno, following up on that point, your last comment in your oral testimony, not your prepared testimony, was the note of a new interpretation of the social contract is emerging and the industry and law must take note. I don't know whether you are part of that academic left or anything, but——[Laughter.]

Mr. DELONG. Present company excepted. [Laughter.]

Senator COLEMAN. Is there a sense that perhaps our notion of what our property rights, traditional property rights may, in fact, be changing? Should they be changing? Talk to me a little about that.

Mr. MORENO. Actually, that comment was only addressed at the instant case, namely the music industry, and I actually, with due respect to one of the Senators who is not here, I am not persuaded that this is the first step in a slippery slope, an attack on the concept of copyright or private property. I don't think that is what is going on here, and I actually think that music itself is a different case from film.

Film takes 90 minutes to 2 hours to watch. You can't walk around on the street watching a movie unless you want to bump into things. Music is different. We can walk around. We can take a minute, 2 minutes to listen to a song.

So I actually think that the social contract that I am referring to is really about access to music and the transformation of musical imagery, auditory images into digitization. That is what I am talking about.

Mr. DELONG. I think that is a very interesting point. I think music is somewhat special, although the movies are getting downloaded. The video game industry has been quite successful at maintaining a sense of community and hasn't been hit as hard. Now, part of that may be simply downloading time, but it is very interesting to talk to them about it. They have some interesting ideas.

Mr. MORENO. And in that case—this is a good example. My son, years ago, even when he was in middle school, would play these video games with other kids online. He had a community of friends online that he would play these—and he still does, with anonymous people playing chess. The file sharing business in music is analogous, I think, in some respects.

Senator COLEMAN. Both of your testimonies indicated a prospect for this thing being resolved down the road. Any sense of how long it will take the market to kind of sort all this thing out? And—I will leave it at that. Any best guess as to how long it takes to bring these sides together, the peer-to-peer folks saying, hey, we are ready to step this forward. We want to make this happen. The music industry says, we are ready to step forward, ready to make it happen. Obviously, that hasn't happened and the focus today are 12-year-old kids or 71-year-old grandmas or Lorraine who was here. So what is your best guess of how long that takes?

Mr. DELONG. I am optimistic. I think with iTune coming on and MusicMatch and the others, they are getting their act together on that and the downloading services is the biggest piece of the puzzle. I would say a couple of years.

Mr. MORENO. I was going to say within 5 years. Capitalism is about innovation, and innovation is stimulated by losing money. [Laughter.]

So I think this is going to move along pretty well. I was going to say 5 years, but I will take 2 years.

Senator COLEMAN. We will put that in an envelope and we will open it up in 2 years.

Mr. MORENO. Oh, oh. [Laughter.]

Senator COLEMAN. I want to thank you both very much for your presence here. Your full testimony will be entered into the record as part of the record.

We will keep the record open for 3 weeks for additional questions from other Senators on the Subcommittee.

So with that, this hearing is adjourned.

[Whereupon, at 1:08 p.m., the Subcommittee was adjourned.]

APPENDIX

Senator Tom Carper
September 30, 2003
Governmental Affairs Committee
Permanent Subcommittee on Investigations
Opening Statement

Thank you, Mr. Chairman, for holding this very timely hearing.

Throughout the debate on this issue, we have heard arguments that illegal file sharing takes place because album prices are too high. We have also heard it said that the recording industry consistently puts out poor quality product that people don't want to pay for, or that they have not been willing to find a way to use the Internet to promote and sell their products.

Regardless of whether or not these allegations are true, we cannot ignore the fact that downloading copyrighted material without permission is illegal. We can argue whether or not the recording industry's recent lawsuits were the best public relations move. I don't believe they were. I do believe, however, that recording artists and other copyright holders have every right to use the tools available to them to enforce the protections placed on their work.

Unfortunately, I don't think there is anything Congress can do to magically end all illegal file sharing. I also don't think that the recording industry suing its customers will bring many of them back to the record stores. It will be helpful, however, if parents teach their children that illegally downloading music on the Internet is just as wrong as stealing CDs from a store. It would also help if the peer-to-peer networks that facilitate piracy took more aggressive steps to prevent their customers from breaking the law.

There are probably additional steps that the recording industry can be taking, as well. I applaud Universal Music for their recent decision to lower prices on all of their CDs. They and other labels should also be applauded for their recent efforts to make more music legally available online. These steps are signs that the recording industry is beginning to listen to their customers. I look forward to hearing today what other steps can be taken to battle piracy and reverse the recent decline in the music industry.

SENATOR FRANK R. LAUTENBERG (D-NJ)
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON PRIVACY PIRACY
Tuesday, September 30th, 2003
S:\LEG\GOVT AFFAIRS\Hearings\09 30 03 Privacy Piracy Hearing Opening Statement.doc

Mr. Chairman:

The media have characterized the ongoing dispute and litigation between the music recording industry and internet service providers as "piracy versus privacy."

I think it's important to understand that <u>both sides</u>, in a sense, need to prevail. We need to stop digital piracy, but not at the expense of privacy.

We all recognize that musicians and the recording industry are losing millions of dollars from copyrighted materials being downloaded and shared for free.

If you want proof, just look at the fact that music CD sales have dropped 26 percent since 1999. Meanwhile, the number of blank, recordable CDs sold at retail increased by 40 percent last year alone.

Piracy is not only affecting the music industry. Two weeks before the big screen release of the summer block-buster "The Hulk," bootleg copies of the film started showing up on computer networks around the world.

It cost Universal Studios 150 million dollars to make "The Hulk," yet anyone with a high-speed internet connection could see it for free.

This problem for the movie industry will only get worse when technology freely allows consumers to trade or swap movies similar to the way they now trade music files.

The bottom line here is that the music and movie industries and internet services providers will have to get creative and invest in consumer education, and new products that are more difficult to copy. That kind of collaboration may be preferable to a "legislative fix" since technology is always faster than Congress!

I look forward to hearing from the witnesses on this important subject.

Thank you, Mr. Chairman

STATEMENT OF SENATOR RICHARD J. DURBIN

Before the

Committee on Governmental Affairs
Permanent Subcommittee on Investigations

"Privacy & Piracy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry"

September 30, 2003

This timely hearing addresses an urgent issue that I believe all of us – as lawmakers, citizens, and parents – must pay close attention to.

With all the important and life-changing benefits that the Internet has brought us over the past decade and a half, the new technology has also made it much easier for some of the most undesirable elements of our society to hawk their wares.

We are all too familiar with the rampant availability of pornography, gambling, scams, financial crimes, and violent video games on the Internet. It is essential that we do everything in our power to keep our children and other vulnerable members of our society from being exposed to such offensive or inappropriate materials online.

There is even more danger lurking on the Internet that, perhaps at first blush, may not appear to be so threatening. The Internet and peer-to-peer (P2P) networks in particular have become popular and widely used platforms for blatant theft and abuse of copyrighted materials.

While the negative impact to children from illegally downloading music and movies may not be quite comparable to the damaging effects of their exposure to pornography and other hazards on the Internet, the economic and moral impact of such wholesale infringement of copyrighted materials is incredibly damaging to our society at large.

Widespread piracy of copyrighted music, motion pictures, software, and other files through the use of P2P programs is hurting our creative industries to the detriment of our national economy. If we do not stop the bleeding soon, the copyright industries – constituting 5 percent of our gross domestic product and the single largest United States export category – could suffer irreparable damage.

I realize that Congress attempted to deal with this problem in the past when we enacted the Digital Millennium Copyright Act (DMCA) in 1998. And the copyright holders took the matters into their own hands by filing lawsuits against the companies who facilitate the wholesale infringement of their intellectual property.

But I'm afraid that the technology is once again a step ahead of the laws as newer and better file sharing systems have now appeared in cyberspace to replace Napster and other programs that courts have found to be unlawful.

These new file sharing companies, like Kazaa and Grockster, purport that they simply allow the direct exchange of files between one computer and another, and they should not be held responsible for the content. That is not acceptable.

I think we need to learn more about who these companies are, and how these new P2P systems actually work. We also need to examine how our laws may be deficient as they apply to these new systems, and find ways to impose liability for anyone who profits from copyright infringements that take place on their systems.

I also believe the Internet Service Providers (ISP) have a significant role in developing a consensus solution to this urgent problem.

Many ISPs have found themselves caught between a rock and a hard place, where they are required to disclose basic identifying information about some of their customers to copyright holders who file legitimately issued subpoenas under the DMCA. But they also believe such disclosure could harm the privacy rights of their customers, which is not an unreasonable position on their part.

Some ISPs are currently in litigation with copyright holders over the legal issue of DMCA's scope, and I know from other hearings that they have contrasting views on this issue. I believe it would have been helpful to have the voice of ISPs represented at today's hearing in order to ensure a balanced investigation by this Subcommittee.

I also believe that the ultimate responsibility falls on all of us as parents to educate our family members on what is and is not acceptable behavior for "Netizens."

I have spoken to many parents who tell me about how their children are so proficient with computers, and that they spend hours at home online, listening to music. But I also know that many parents have no idea what their children are actually doing on the computer, and many still do not have an interest in knowing, as long as the computers help keep their children off the streets and away from what they perceive to the real dangers out there.

The Recording Industry Association of America (RIAA), which has received some criticism this month for its unenviable decision of having to file hundreds of lawsuits against infringers, said this:

> "The music community's efforts have triggered a national conversation – especially between parents and kids – about what's legal and illegal when it comes to music on the Internet. In the end it will be decided not in the courtrooms, but at kitchen tables across the country. We are heartened by the response we have seen so far."

I could not agree more – and I encourage everyone in our communities, especially the parents, to begin this conversation now.

I look forward to hearing from the witnesses, as this Committee continues to investigate this very important issue. Thank you.

STATEMENT OF MITCH BAINWOL
CHAIRMAN & CEO
RECORDING INDUSTRY ASSOCIATION OF AMERICA
BEFORE THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ON
"PRIVACY & PIRACY: THE PARADOX OF ILLEGAL FILE SHARING ON PEER-TO-PEER NETWORLS AND THE IMPACT OF TECHNOLOGY ON THE ENTERTAINMENT INDUSTRY"

September 30, 2003

Thank you Chairman Coleman and Senator Levin for the opportunity to testify here today.

My name is Mitch Bainwol. I am the Chairman and CEO of the Recording Industry Association of America, the trade association representing the U.S. recording industry. RIAA members create, manufacture and/or distribute 90 percent of all legitimate sound recordings in the United States.

I'd like to take this opportunity to provide the Committee with some background, insight and perspective on our multi-pronged efforts to combat the devastating effects that the massive illegal copying on peer-to-peer networks is having on the music industry. The problems currently facing the music industry will, as broadband expands, soon be the problems of all copyright holders. This is a point of national importance, as the copyright industries constitute five percent of the Gross Domestic Product and copyrighted works are the single largest United States export.

The decision to enforce our rights against egregious infringers was taken only after suffering years of mounting harm and trying all other avenues. The music industry first tried to use an aggressive public education campaign to discourage the unauthorized distribution of recordings, by explaining to the public that online piracy is not only illegal, but robs songwriters and recording artists of their livelihoods, stifles the careers of up-and-coming musicians, and threatens the jobs of tens of thousands of less celebrated people in the music industry.

The music industry also pursued lawsuits against the peer-to-peer systems, which are knowingly facilitating the illegal distribution of copyrighted recordings on a massive scale. Most important, the music industry has aggressively licensed legitimate online music services to offer legal alternatives to consumers. Only after these steps did not stem the tidal wave of illegal conduct has RIAA resorted to its current course, pursuing the users of peer-to-peer networks who are distributing substantial amounts of unauthorized copies of recordings. And there is one point on which all of the courts have agreed: these users are violating the copyright laws. Our

heightened enforcement efforts are deliberately occurring now when, as a result of the music industry's extensive educational efforts, the public is more aware than ever before of the illegality and consequences of online piracy and, at the same time, the number of legitimate online music sources is exploding, giving music lovers a multitude of options for legally obtaining music online.

The Piracy Problem Facing the Music Industry

In the past three years, shipments of recorded music in the United States have fallen by an astounding 26 percent, from 1.16 billion units in 1999 to 860 million units in 2002. And worldwide, the recording industry has shrunk from a $40 billion industry in 2000 down to a $32 billion industry in 2002. Hit records – which are critical to the long-term health of the music industry and enable investment in new artists and new music – have suffered most dramatically. In 2000, the ten top-selling albums in the United States sold a total of 60 million units. In 2001, that number dropped to 40 million. Last year, it totaled just 34 million.

The root cause for this drastic decline in record sales is the astronomical rate of music piracy on the Internet. Computer users illegally download more than 2.6 billion copyrighted files (mostly recordings) every month. At any given moment, well over five million users are online offering well over 1 billion files for copying through various peer-to-peer networks. Peer-to-peer networks allow a user to make media files, including recordings, stored on that user's computer available for copying by others; to search for media files stored on other users' computers; and to transfer exact copies of the contents of other users' media files to that user's own computer. A song can be copied and distributed in this manner an unlimited number of times, without any degradation in sound quality. And unlike traditional music piracy, piracy through networks is viral: unless the user takes affirmative steps to prevent it, the user automatically and immediately begins offering the files that the user copied to millions of other users. Moreover, the overwhelming majority of the distribution that occurs on peer-to-peer networks is unauthorized.

It is widely recognized and acknowledged that individuals who engage in such unauthorized distribution – either by making recordings available for others to copy or by making copies of others' files – are committing a clear violation of the copyright laws. The courts have been unanimous on this point. As the Ninth Circuit explained in the *Napster* case, "a majority of Napster users use the service to download and upload copyrighted music. . . . And by doing that, . . . the uses constitute direct infringement of plaintiffs' musical compositions, recordings." Judge Wilson quoted this language in the recent *Grokster* case, and similarly recognized that many Grokster and Streamcast users were downloading copyrighted music, "thereby infring[ing] [copyright owners'] rights of reproduction and distribution." Most recently, in a case involving Aimster, Judge Posner of the Seventh Circuit noted that Aimster users who were distributing or making copies of copyrighted music were copyright infringers, and that there was no evidence in the record before him that Aimster "has ever been used for a noninfringing use."

According to a November 2002 survey by Peter D. Hart Research, by a nearly 2-to-1 margin, consumers who say they are illegally downloading more music report that they are

purchasing less music. The same survey found that the main reason consumers are not buying more music is that they get a lot of what they want for free by illegally downloading or copying it from others. In a similar study conducted in May 2002 by Peter D. Hart Research, among 12- to 18-year-olds, 35 percent say the first thing they will do after hearing a new song that they like is download it, versus just 10 percent who will buy it. Among 19- to 24-year-olds, 32 percent download the new song first, versus 9 percent who will buy it.

These findings are bolstered by a June 2003 Edison Media Research report which found that "among the heaviest downloaders, 48% say they no longer have to buy CDs because they could download music for free over the Internet" – an increase of 61 percent in just one year. It is thus not surprising that, while sales of music CDs are dropping, sales of blank CDs (onto which downloaded recordings can be copied) have increased dramatically, by more than 30 percent in 2002. Sales of blank CDs now outstrip sales of music CDs by a more than 2-to-1 margin.

These findings are consistent with the skyrocketing number of users of peer-to-peer networks. As of July 2002, Kazaa – the most popular peer-to-peer network by far – boasted 100 million registered users. By May 2003, Kazaa had become the world's most downloaded software program of any kind, with 278 million downloads.

Although these peer-to-peer networks are well aware of the rampant illegal copying that occurs over their systems, they have taken no concrete steps to stop it, and in fact, they encourage and enable that conduct, while at the same time taking steps to shield themselves from liability. They provide no meaningful warning to their users that uploading or downloading copyrighted recordings violates the law. They provide no filter to prevent exchange of copyrighted material, even though many provide filters that at least attempt to block pornography and viruses. Peer-to-peer networks also establish "default" settings that, unless affirmatively changed by the user, automatically make the files on the user's hard drive available for copying by anyone else on the network. And, as John Malcolm the Deputy Assistant Attorney General of the Criminal Division noted in testimony before the Judiciary Committee earlier this month, in order to foster anonymity on the network:

> "many peer-to-peer networks do not require individual users to set up accounts with a central authority. Peer-to-peer users can change their names at will and the names that they choose rarely contain true information that would identify them."

As Judge Wilson observed in the movie and music industries' case against Grokster, Streamcast, and Kazaa, these peer-to-peer networks "may have intentionally structured their businesses to avoid secondary liability for copyright infringement, while benefiting financially from the illicit draw of their wares." Indeed, Kazaa has established itself in the country of Vanuatu, while the illegal activities on its network are causing the loss of numerous jobs in the music industry in the United States. Taken together, all of these factors are clear evidence that the KaZaa's of the world have done and will do anything within their power to facilitate copyright infringement and avoid accountability or legal liability for their actions.

Verizon and SBC also Benefit from Piracy

Although Internet service providers, like Verizon and SBC, are in a unique position to educate their customers about the myriad of threats – legal, privacy, security -- posed by using P2P systems, they have chosen instead to do nothing to educate or warn subscribers. For example, nowhere in Verizon's or SBC's brochures, websites, or advertising are there any warnings or information about the real legal risks associated with using P2P software to get free music. To the contrary, both SBC and Verizon have used a combination of overt and subtle marketing strategies to encourage people to sign up for DSL so they can get all the music they want for free and not have to go to the record store anymore.

The motivation for this strategy is clear when you look at the broadband landscape.

According to a recent USAToday article, 70% of Americans with broadband capabilities use cable modems instead of DSL. The same article quotes an Internet analyst saying: "It's going to be more streaming video and music downloading that's really going to dictate the switch — far more than the price." And a recent report on broadband found that the "growth in peer-to-peer is really driving the market, . . . [and] P2P traffic now consumes 50% to 70% of the capacity . . . up from perhaps 20% to 30% a year ago, . . .".

With a long way to go before catching up to cable, it's no wonder Verizon and SBC – the nation's two largest DSL providers – are reluctant participants in the fight against online piracy. Fortunately, for the copyright community, the vast majority of other ISPs around the nation have been responsible and constructive partners in this important fight.

It's difficult to discount the commercial interests of Verizon and SBC when weighing the merits of their arguments. After all, rather than focusing on the most pressing problems facing their customers, they champion protecting the anonymity of subscribers who are engaged in clearly illegal activity. So while millions of their users are breaking the law while exposing their most sensitive personal information to the world, Verizon and SBC want Congress to believe that the true threat to their consumers is the DMCA information subpoena process and the RIAA, not the KaZaa's of the world. If Verizon and SBC spent as much time and resources educating their customers about the illegality of using P2P services to get free music as they have fighting the RIAA in Court and in Congress, the Internet piracy landscape might look a whole lot better.

The Availability of Legal Online Music

The widespread availability of free illegal copies to download through these peer-to-peer networks has greatly interfered with the development of legitimate online sources of music. But music lovers need not break the law to obtain their favorite music online. The music industry continues to respond to consumer demand by making its music available to a wide range of authorized online subscription, streaming, and download services that make it easier than ever for fans to get music legally on the Internet. There are now many legal and inexpensive ways to get music online. In the United States market alone, there are dozens of excellent legitimate online services that offer a variety of choices to enjoy and purchase online music. These services include:

aolmusic.com, apple.com/music, audiocandy.com, bestbuy.com, bet.com, buymusic.com, catsmusic.com, CircuitCity.com, collegeconcerts.com, cornercd.com, dimple.com, dothehole.com, earwax.com, efetus.com, emusic.com, exitosmusical.com, facethemusic.com, fullaudio.com, FYE.com, galleryofsound.com, independentrecord.com, instavid.com, latinoise.com, liquid.com, burnitfirst.com, listen.com, mainstreetmusic.com, millenniummusic.com, miramag.com, mp3.com, mtv.com, musicmatch.com, musicmillennium.com, musicnet.com, musicrebellion.com, netscape.com/music, newworldrecord.com, phillysoulclassics.com, pressplay.com, qhut.com, rasputinmusic.com, real.com/realone/rhapsody, recordandtapetraders.com, rollingstone.com, samgoody.com, spinner.com, streamwaves.com, tophitsmusic.com, towerrecords.com, windowsmedia.com.

Indeed, the number of legitimate online sources of music is continuing to increase. Additional major retailers and software companies – including companies that are household names – plan to enter the online market within the next six months.

The Music Industry's Massive Educational Campaign

The music industry has, for a number of years, undertaken a massive campaign to educate consumers regarding the illegality of the unauthorized distribution of copyrighted music online. Recording industry leaders, along with an unprecedented coalition of other groups like the National Music Publishers' Association, the Country Music Association, the Gospel Music Association, the American Federation of Television and Radio Artists, American Federation of Musicians, ASCAP, BMI, SESAC, the Songwriters Guild of America, Nashville Songwriters Association International, National Association of Recording Merchandisers, and many others, as well as individual songwriters, recording artists, retailers, and record companies have been educating music fans that the epidemic of illegal distribution of music not only robs songwriters and recording artists of their livelihoods, but also undermines the future of music itself by depriving the industry of the resources it needs to find and develop new talent. In addition, it threatens the jobs of tens of thousands of less celebrated people in the music industry, from engineers and technicians to warehouse workers and record store clerks.

The message of this campaign has been very clear: copying or distributing copyrighted music over the Internet without permission is stealing, plain and simple. Downloading illegal copies is no different than shoplifting CDs out of a record store, and uploading those recordings for others to illegally copy is no different than handing out stolen CDs on the street corner – and the act of downloading or uploading music on peer-to-peer networks is not an anonymous one. This message has been conveyed to the public in a series of print and broadcast ads featuring more than a hundred major artists and songwriters who ask their fans to stop stealing their music. These ads have appeared in a wide variety of outlets, including USA Today, BET, and MTV. The Grammy award-winning artists participating in this campaign range from country artists Brooks & Dunn and Martina McBride to rock artist Peter Gabriel to Christian artist Steven Curtis Chapman to opera star Luciano Pavarotti to hip hop artists DMX and Missy Elliot to legends Stevie Wonder, Brian Wilson, Don Henley and Elton John, among many others. Other

participants include songwriters, session musicians, and retail store owners discussing the impact of music piracy in terms of lost sales, lost jobs, and closed stores.

This antipiracy message is also featured on a music industry website, www.musicunited.org, which contains a number of clips from this educational campaign. The website also includes a wide array of pertinent information, including a description of the governing law, a list of legal online music sources, a guide for parents, as well as step-by-step instructions on how to disable or uninstall peer-to-peer software used to illegally offer music for copying.

Since April 2003, RIAA has been sending Instant Messages – and has now sent well over 4 million – directly to infringers on peer-to-peer networks. These messages inform infringers that their actions are illegal and direct them to the Music United website (www.musicunited.org) for information on how they can avoid breaking the law. While some users are responding to RIAA's messages by ceasing their illegal conduct, others have chosen to react by questioning RIAA's enforcement campaign rather than their own conduct. Kazaa, far from cooperating with this attempt to educate its users about the law, reconfigured the newest version of its software to disable the instant messaging system, thereby preventing RIAA from sending messages to Kazaa's newest users. Kazaa did not, however, change its "default" settings, which, as noted above, automatically make each user's files available for copying by others.

Moreover, prior to filing suits, RIAA publicly announced its intent to do so, giving infringers another opportunity to discontinue their illegal conduct. Since our enforcement effort commenced, virtually every major newspaper and television news channel, and hundreds of local news outlets, has covered our efforts. One of the benefits of this heightened awareness is that millions of parents around the nation are beginning, possibly for the first time ever, to talk to their children about what they are doing online.

The Information Subpoena Provision of the Digital Millennium Copyright Act

As you know, RIAA is collecting evidence pursuant to what is commonly referred to as the information subpoena provision of the Digital Millennium Copyright Act ("DMCA"), which is 17 U.S.C. §512(h). Congress enacted the DMCA in 1998 to encourage development of the Internet's potential, while at the same time protecting against the "massive piracy" of copyrighted works that Internet technology permits. One of the purposes of the DMCA was to allow copyright holders to enforce their copyrights against direct infringers rather than the Internet Service Providers ("ISPs"). Thus, in crafting the DMCA, Congress included a fair and balanced procedure – the information subpoena provision – to ensure that copyright owners, with the help of ISPs, have an accessible and efficient mechanism for identifying individuals who are using the Internet to commit piracy.

The balance struck by Congress in §512 was the result of a give and take – in the best sense – between the interests of ISPs and copyright owners, and the need to protect consumers. Congress recognized that traditional enforcement remedies available to copyright owners were insufficient in an era in which massive amounts of piracy could occur instantly at the hands of anyone with an Internet connection.

ISPs recognized that in a digital world they could have exposure to copyright claims, and thus sought from Congress limitations on liability in the DMCA. ISPs wanted copyright owners to focus on the direct infringers, but recognized that ISPs often would be the sole source for identifying individuals who are engaged in online piracy. So, in exchange for exempting ISPs from any monetary liability for the infringing activities occurring on or over their networks and connections (subject, of course, to certain prerequisites), Congress created a framework by which copyright owners, with the assistance of ISPs, could expeditiously identify individuals engaging in infringing activities online. That compromise – expeditious access for copyright owners to identifying information of infringers, in exchange for broad liability limitations for ISPs – is as fair today as it was in 1998.

It is important to note that absent the broad liability limitations of the DMCA, ISPs would most certainly be liable for secondary copyright infringement for the actions of their subscribers. ISPs who resist DMCA subpoenas are trying to enjoy the safe harbor benefit provided them by the DMCA, without shouldering the minimal corollary burden of responding to subpoenas, which is even less burdensome than would be responding to a notice to remove infringing material from their networks. That fact helps explain why Judge Bates – the federal district judge who presided over the subpoena enforcement proceedings between RIAA and Verizon – concluded as follows: "It would not serve the public interest for Verizon to continue to receive the benefits of the [DMCA] – liability protection – without the concomitant obligations of disclosing the identity of an alleged infringer [under §512]."

To achieve their purpose, DMCA subpoenas must bear fruit quickly. An individual Internet pirate can cause tens of thousands of infringing copies to be distributed in a single day. In the case of recordings that have not yet been released publicly, the economic impact of this viral propagation can be devastating. Thus, as Judge Bates noted, Congress provided "express and repeated direction to make the subpoena process 'expeditious.'"

At the same time, Congress carefully built safeguards into §512 to ensure that it is used only to enforce valid copyright claims. A copyright owner or its agent must supply a "sworn declaration to the effect that the purpose for which the subpoena is sought is to obtain the identity of an alleged infringer and that such information will only be used for the purpose of protecting rights under this title." 17 U.S.C. §512(h)(2)(C). The copyright owner must also file a notification that, among other things, identifies material being infringed and information sufficient to allow the service provider to locate the material and, if appropriate, disable access to it. By substantially complying with this notification requirement, the copyright owner or its agent has established the bona fides of its ownership and claim of infringement.

RIAA recognizes that a failure to adhere to any of these requirements is a justification for denying the subpoena and that any copyright owner who misrepresents itself in satisfying these requirements is potentially liable for damages, including attorney's fees. Thus, as described further below, RIAA takes great care to ensure that a user is illegally distributing or copying copyrighted recordings before it files a request for a subpoena.

Moreover, although the DMCA sets forth the minimum requirements for seeking a subpoena, RIAA is not seeking a subpoena as to everyone who is illegally distributing copyrighted recordings. Rather, at this time, RIAA is focusing on egregious infringers, those who are

engaging in substantial amounts of illegal activity. In so prioritizing its efforts, RIAA is acting no differently than anyone in this country whose property rights have been violated and who is faced with a decision whether to press a legal claim: we are making a judgment as to whether pursuing a possible lawsuit is appropriate given the circumstances.

As discussed above, peer-to-peer networks like FastTrack and Gnutella are, by design and practice, open networks that enable individual users to search for and copy files located on the hard-drives of other users on the network. To gather evidence against individual infringers, RIAA typically uses software that searches the public directories available to any user of a peer-to-peer network. These directories list all the files that other users of the network are currently offering to distribute. By logging onto these open networks and searching for recordings owned by RIAA's members just like any other user, the software finds users who are offering to distribute copyrighted music files. When the software finds such a user, it downloads a sample of the infringing files, along with the date and time it accessed the files, and locates the user's Internet Protocol ("IP") address. Additional information that is publicly available allows RIAA to then identify the infringer's Internet Service Provider.

Before acting on any of the information obtained by the software, an employee at RIAA manually reviews and verifies the information. And, before filing a request for a subpoena, RIAA sends the infringer's ISP advance notice that RIAA intends to issue a subpoena with respect to a particular IP address. Among other things, that allows the ISP, if it wishes, to notify its subscriber that its account is soon to be the subject of a subpoena request. Only after completing all of these steps does RIAA request a subpoena from the clerk of court (using the standard set forth in the DMCA as discussed above), seeking from the ISP identifying information for the individual whose account was being used to distribute the copyrighted music.

As demonstrated by our first-round of lawsuits, RIAA is in no way targeting "de minimis" users. RIAA is gathering evidence and preparing lawsuits only against individual computer users who are illegally distributing a substantial amount of copyrighted music. As indicated above, the subpoenas issued at the request of RIAA thus far involve infringers distributing, on average, 1000 copyrighted recordings. That said, RIAA does not condone any illegal copying – and does not want anyone to think that even a little illegal activity is acceptable. Indeed, in the case of a recording that has not yet been released, the illegal distribution of just that one file can have a devastating impact on the sales of the forthcoming album.

Last spring, the record companies brought suits against college students who had established and were running unauthorized peer-to-peer networks on their college networks, on which they were illegally distributing tens of thousands of recordings. The industry settled those cases for $12,500 to $17,000. While every case is unique, we intend to be similarly fair and proportionate with respect to individual infringers and to consider each individual's circumstances.

As discussed above, the DMCA itself builds in ample safeguards for the privacy of individuals. As Judge Bates held, "These [§512 information subpoena] protections ensure that a service provider will not be forced to disclose its customer's identifying information without a reasonable showing that there has been copyright infringement" and "[t]hese requirements

provide substantial protection to service providers and their customers against overly aggressive copyright owners and unwarranted subpoenas." As Judge Bates noted in his decision, the DMCA subpoena process "provide[s] greater threshold protection against issuance of an unsupported subpoena than is available in the context of a John Doe action." This is undoubtedly true.

Under the DMCA subpoena process, there are statutory limits on the type of information a copyright owner can obtain via subpoena and the purpose for which that information can be used. Under a DMCA subpoena, a copyright owner can only receive information that is necessary to identify and contact the alleged infringer – such as a name, address, phone number, and e-mail address. More importantly, the copyright owner is statutorily limited to using that information exclusively for purposes of enforcing its copyright. Compare that to filing a "John Doe" lawsuit, in which any aggrieved party could issue a subpoena requesting anything relating to the subscriber account, including user habits, website visits, and payment records. Moreover, once that information has been provided to a copyright owner via a subpoena in the context of a John Doe lawsuit, there are no statutory restrictions whatsoever on how it can be used or with whom it can be shared.

In short, requiring copyright owners to file John Doe lawsuits would provide fewer protections to an ISP's subscribers, while effectively depriving copyright owners of expeditious access to an alleged infringer's information. That would defeat the careful balance crafted by Congress in the DMCA. Moreover, a substantial influx of John Doe suits would be much more burdensome on the court system. If RIAA were filing John Doe lawsuits in place of each of these DMCA subpoenas, that would affect not only the clerk's office but also the judges.

RIAA shares your concern with respect to not overwhelming the court. It thus has worked with the clerk's office, since prior to beginning our heightened efforts, to establish a process (including providing files electronically) that is acceptable to the court, and has issued its subpoenas on a rolling basis to minimize any impact on the workings of the clerk's office. Moreover, RIAA is willing – and would very much like – to reduce substantially the number of subpoenas it issues by providing multiple IP addresses for the same ISP on each subpoena. RIAA believes the DMCA allows this practice but, because many of the ISPs have objected, to date the RIAA has issued separate subpoenas for each IP address. Providing multiple addresses per subpoena would significantly reduce the administrative tasks for the clerk's office, and any support you could provide on this issue would be greatly appreciated.

Copyright infringers on peer-to-peer networks should have little expectation of privacy. Individuals on peer-to-peer networks have opened their computers, permitting access to countless others to copy whatever they wish. As Judge Bates observed, "it is hard to understand just what privacy expectation he or she has after essentially opening the computer to the world." The use of peer-to-peer networks is not anonymous: the user's IP address is publicly available to anyone else on the peer-to-peer network, and the user's ISP can determine which subscriber was using that IP address. Moreover, almost all ISPs disclose in their User's Terms of Service that, pursuant to the DMCA, they must provide the subscriber's identity to a copyright holder when there is reason to believe copyrights are being infringed. For example, Verizon informs its

subscribers that it will "disclose individual customer information to an outside entity . . . when Verizon is served with valid legal process for customer information."

Conclusion

Although there is no silver bullet solution to the growing problem of music piracy over the Internet, we believe that a three-prong approach to the problem consisting of education, legitimate alternatives, and enforcement, is a fair and balanced strategy for revitalizing the music industry in the digital age. Thank you again for the opportunity to testify and I look forward to answering the Committee's questions.

Thoughts on the digital future of movies,
The threat of piracy,
The hope of redemption

presented to the
Permanent Subcommittee on Investigations
Senate Committee on Governmental Affairs

Hearing on:
Privacy & Piracy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry

On behalf of the member companies of
THE MOTION PICTURE ASSOCIATION OF AMERICA

by

Jack Valenti
President and Chief Executive Officer

September 30, 2003
Washington D. C.

The Peril of Piracy and
the value of movies and Intellectual Property
to this nation

It was said that during World War I, French General Foch, later to be Supreme Allied Commander, was engaged in a furious battle with the Germans. He wired military headquarters, "My right is falling back, my left is collapsing, my center cannot hold, I shall attack!"

Some say this version is apocryphal. I choose to believe it is true, because that is precisely the way I feel about the assault on the movie industry by 'file-stealers,' a rapidly growing group whose mantra is "I have the technological power to use as I see fit and I will use it to upload and download movies, no matter who owns them for I don't care about ownership."

To paraphrase Mr. Churchill, I did not become the head of the Motion Picture Association to preside over a decaying industry. I am determined to join with my colleagues in making it plain that we will not allow the movie industry to suffer the pillaging that has been inflicted on the music industry. This Committee understands, I do believe, that the movie industry is under attack. And this Committee would agree, I do believe, that we must counter these attacks NOW with all the resolve and imagination we can summon. To remain mute, inert, to casually attend the theft of our movies would be a blunder too dumb to comprehend.

This is not a peculiarly Hollywood problem. It is a national issue that should concern the citizens of this free and

loving land. Why? Because the Intellectual Property community is America's greatest trade export and an awesome engine of growth, nourishing the American economy. Intellectual Property (movies, TV programs, home video, books, music, computer software) brings in more international revenues than agriculture, aircraft, automobiles and auto parts – it is also responsible for over five percent of the GDP – it is creating NEW jobs at THREE times the rate of the rest of the economy, at a time when we are suffering some 2 million job losses. The movie industry alone has a surplus balance of trade with every single country in the world. I don't believe any other American enterprise can make that statement – and at a time when this country is bleeding from a $400 billion-plus deficit balance of trade.

The very future of this awesome engine of economic growth is at stake. Happily, our movies draw large crowds to the theaters. But record box-office revenues should not blind anyone to the fact that the movie industry sits on a fragile fiscal bottom. The average film costs over $90 million to make and market. Only one in ten films ever gets this investment returned through theatrical exhibition. Films have to journey through many market venues – premium and basic cable, satellite delivery, home video, network and individual TV stations, international – in order to try to recoup the private risk capital that brings a movie to life.

If a film is kidnapped early in that journey, it's obvious the worth of that film can be fatally depleted long before it can retrieve its investment. Piracy means fewer people buying DVDs, less revenue, and fewer movies being made.

Especially hurt will be creative ventures outside the mainstream that involve greater financial risk.

Add to that the fact that in this country almost one million men and women work in some aspect of the movie industry. These are not high-salaried jobs. They are held by ordinary Americans with families to feed, kids to send to college and mortgages to pay. Their jobs, their livelihoods, are put to extreme peril if we bear witness to the slow undoing of one of America's most valuable job-producing industries.

The Onslaught grows *in force and speed*

An outside research group has estimated that 400,000 to 600,000 films are being illegally abducted every day. We know this will increase exponentially in the future. The speed of broadband is nothing compared to the supersonic download speeds being developed right now.

Scientists at CalTech have announced "FAST," an experimental program that can download a DVD quality movie in five seconds! Another experiment at Internet II has dispatched 6.7 gigabytes – more than a typical movie – halfway around the world in one minute! Internet II has conducted new experiments that will make that earlier triumph seem like a slow freight train. These technologies are not decades away. What is experiment today will be in the marketplace a few years from now. Can anyone deny that these huge download speeds brood over our future? Can anyone deny that when one can upload and download movies

in seconds or minutes the rush to illegally obtain films will reach the pandemic stage? Can anyone deny the degrading impact this will have on the movie industry? And can anyone deny that limitless stealing of creative works will have a soiling impact on the national economy?

Not only is this piracy endemic in the United States, it flourishes abroad, though most of the pilfering is in the analog format: videocassettes and optical discs, as well as counterfeiting of DVDs. A good part of that thievery springs from organized criminal organizations. We have organized anti-piracy operations throughout the world. We are partnered with local groups in Japan, Great Britain, Germany, France, Italy, in Latin America and other countries where we are every day vigilant, for like virtue we are every day besieged. We estimate that we lose some $3.5 billion annually in analog and optical disc piracy.

We also know that much of the hard-goods pirated products, especially of films in theatrical release, are the result of people illegally camcording movies in theaters, and then distributing them over the Internet. Then they are stamped onto optical disks and sold for pennies on the streets of Asia and Eastern Europe, even before the movie has a chance to open in those countries. It is not pleasant for legitimate dealers and distributors to watch this breakdown in law and ethics.

What incentive will companies have to create, nourish and market digital movies online when they are kidnapped and flung around the world? Can high value legitimate creative works live in an environment of abundant theft

unchecked and growing? Will legitimate sites (which I will describe below) stand a chance of success competing against blinding-fast speeds of downloads and all for "free"? How does anyone answer that?

President Kennedy once told a story about a French general in Algeria who ordered his gardener to plant a certain species of tree to line the pebbled drive to his chateau. The gardener, astonished, said, "But mon General, that tree takes fifty years to bloom." To which the General responded, "Ah, we haven't a moment to lose. Plant them today." Precisely the way the movie industry address its future – we must plant today the barriers and rebuttals to movie stealing that will go on unchecked tomorrow unless we move with swiftness, resolve and efficiency.

The dark world of Peer-*to-Peer (P2P) so-called file-swapping sites*

We know that the infestation of P2P not only threatens the well-being of the copyright industries but consumers and their families as well. As hearings in the House and Senate have conclusively established, downloading KaZaa, Gnutella, Morpheus, Grockster, etc., can lay bare your most private financial and personal information to identity thieves. It can bring into your home and expose your children to pornography of the most vile and depraved character imaginable. Most insidious of all, the pornography finds its way to your children disguised as wholesome material: your son or daughter may "search" for "Harry Potter" or "Britney Spears," and be confronted with files that contain bestiality or child pornography. The pornography distributed through

P2P networks is so horrific that the District Attorney from Suffolk County, New York, recently called it the worst his office had ever seen on the Internet. And the most disturbing fact of all is that any 10-year old can easily and swiftly bring down this unwelcome perversion.

Therefore, the business model that current P2P networks celebrate as "the digital democracy" is built on the fetid foundation of pornography and pilfered copyrighted works.

I invite members of this Committee to go online to KaZaa and see for yourself the mammoth menu of copyrighted works available FREE, as well as an endless listing of the most throat-choking child porn. It's all there, joyously defiant, enticing all to enter and take whatever you want, risk-free. What a wonderful world we live in!

What would be amusing if it were not so unhelpful are the outcries from critics whose hidden objective is to brutalize and shrink the value of copyright if not totally banish it from the Constitution. They always piously insist they are "opposed to violation of copyright" and then move quickly to defend the right of anyone to use P2P file-swapping sites without regard to who owns the material. Anyone who reads their testimony and dissertations will find, in the words of Horace Walpole, "that they swarm with loose and foolish observations."

The amazing Internet and how the movie industry wants to use it.

The Internet, without doubt, is the greatest delivery system yet known to this planet. It has the potential to reshape how we communicate, how we buy and how to enlarge the dispatch of knowledge on a scale never before exhibited.

The movie industry is eager to use the Internet to deploy our movies, thousands of titles of every genre, to homes in this country and around the world. We want to give American families additional options for watching movies. They can make their choices easily, as well, when they want to see a movie. All at fair and reasonable prices, a phrase to be defined by the consumer and no one else.

Already, the industry is working on VideoOnDemand (VOD), so that everything is instantaneous. The consumer clicks a button and the movie is on the screen.

Now available are sites for legitimate movie viewing such as MovieLink, Cinema Now and others. You can call them up immediately and browse through their catalogue titles available. And it's legitimate, not illegal.

There is only one barrier to expand this immense bounty of movies and other entertainment for consumers. It is a forest thickly crowded with outlaws whose mission in life

is to hijack movies and upload them to the Internet; then the feeding begins with illegal downloads. Once we defeat this illegitimacy, the consumers of America will be the cheerful beneficiaries of a never-ending source of high-value entertainment in a lawful environment.

What the movie industry *is doing to baffle piracy*

What is the movie industry doing to find rebuttals to piracy? We are working to address the corrosive effects of piracy by actively and expensively pursuing a comprehensive plan on multiple fronts with every tool we have at our disposal. We have launched an attack on a broad front to go on the offensive against thievery:

(1) We are trying to educate the public about copyright and explain why it is important to the nation. We have created TV public service announcements (I hope you have seen them), and have joined with colleagues in exhibition who are showing trailers in their theaters. We are in an alliance with Junior Achievement and one million students in grades five through nine, to explain and educate why copyright is central to intellectual property growth, and why filching movies in digital form by uploading and downloading on the Net is not only just plain wrong, but has a malignant effect on the future of American consumers.

(2) We have been meeting with a committee representing the nation's universities. These educational institutions are confronted with huge increased costs for large

amounts of storage space and bandwidth in their state-of-the-art broadband systems, which are devoured by P2P networks. Most universities are now offering to students a catalogue which outlines that taking movies and music off the Net is an infringement of copyright and carries penalties. These codes of conduct informs students so they are aware that what they might consider to be okay and easy, is a violation of copyright and has to be taken seriously.

(3) We are investing all our anti-piracy resources to lift the level of law enforcement not only here but in other countries on every continent. In every region of the globe the MPAA has anti-piracy personnel working closely with law enforcement and local governments to keep pirate activity at bay. It's our intention to invest these efforts with more energy and resolve.

(4) We are embarking on a new project – technological research. We aim to enlist the finest brains of the best in the high technology field to develop technological measures and means to baffle piracy. At the same time we are continuing to work with the most inventive men and women in the IT and CE sectors. By embracing these innovative scientists, I believe we can extract from this research more than a few counter-measures to put together a technological framework where all our industries can thrive, to the benefit of consumers. We are hopeful, very hopeful.

The Role of the Congress

The Congress plays a vital role in establishing legitimacy to the marketplace. Through hearings like this, a forum is provided to explore and probe key issues, and allow debate to take place so that all viewpoints are heard and weighed.

Hearings to date in both chambers have exposed the economic dangers of piracy and its links to organized crime and terrorism. Also the hearings have brought to the ken of the public threats to consumers and the economy by piracy on a swollen scale and pornography easily available to youngsters.

I am sure this Committee understands that in 1998 many meetings took place between all the parties involved in the DMCA legislation. I know very well because I was personally present and active in those meetings. In our conclusions, the ISPs got what they very much wanted, a safe harbor from liability. The copyright holder was given the tools necessary to identify infringers operating in cyberspace. The ISPs were in agreement with the details of the DMCA because they loved that which benefited them. It is wrong for ISPs to revisit an agreement they approved without hesitation.

Copyright holders have a firm belief that the Congress will never approve any legislation to strip copyright holders of their rights, and will never allow America's greatest trade export to become the victim of theft. This we believe.

Statement of Mike Negra
President, Mike's Video, Inc. (Mike's Movies and Music)
State College, Pennsylvania
Before the Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate
on
"Privacy & Piracy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry"

September 30, 2003

Chairman Coleman and Senator Levin, distinguished Senators, my name is Mike Negra, and I am the President of Mike's Video, Inc., a small business of movie rental and music stores in State College, Pennsylvania. I would like to thank you for allowing me the opportunity to tell my story which has been mirrored all over the country these past 3 years.

First, I will offer you a little background on my business and me. I entered the entertainment business in 1973 when I was an undergraduate at the University of Maryland. While a student I joined the stage crew for major concert productions. In 1974 I became the stage manager and in 1975 was elevated to concert manager, producing acts such as Elvis Presley, Frank Zappa and Linda Ronstadt. It was my responsibility to review contracts, handle all staffing, ticketing, production, security, artist relations, and more. After graduation, I continued in this aspect of the business by touring as a production or road manager with artists such as Geoff Muldaur, Scarlet Rivera, Tim Curry, the Yellow Magic Orchestra and Rupert Holmes. I left the road in 1980 to pursue other interests in the entertainment industry, booking local bands in the DC area and freelancing concert production and promotions.

In 1984 my family and I moved to State College, PA, home of Penn State University, to open Mike's Video, a movie rental retail store that also sold VCRs and TVs. We expanded to include major appliances in 1989 and in 1993 added music and software to our merchandising mix. In 1995 we expanded our music inventory to three of our four stores, completing the rollout in 1999. Also in 1999 we expanded to Blacksburg, VA, home of Virginia Tech University.

Business was fantastic! In 1999 we eclipsed $3 million dollars in music sales, ranking us in the top 50 accounts with some major suppliers. We were experiencing rapid growth, due in large part to the market we were serving: college students. Their appetite for entertainment, both movies and music was healthy and recession proof.

That all changed abruptly in August of 2000 when Penn State and Virginia Tech students returned for their fall semester. At both locations, sales fell dramatically. In State College, our downtown student-oriented store saw sales drop $28,000 in the month of August, a 29% decrease. In Blacksburg, sales decreased by $11,000, a 25% drop. This slide continued for the rest of 2000. From August to December 2000 music sales decreased by 23% company wide.

It was the year of Napster, and college students, with access to broadband Internet connections provided by the university, a lack of discretionary dollars and plenty of time, were among the first heavy users of Peer-to-Peer (P2P) software. College town record stores like mine were the first to feel the brunt of lost sales. Underground retail stores sprung up in dorms and apartment buildings. Students downloaded new music before it was available in stores and sold illegal copies to friends, laughing all the way to the bank. And why not? Their inventory did not cost them a dime, and there was no risk of getting caught.

The downslide has continued ever since. In 2001 sales fell 24 % in State College. We were forced to sell the store in Blacksburg, VA due to disappointing sales but even the buyer, another record store, didn't want the music -- only the movies.

In 2002, as KaZaA and other P2P services expanded our sales continued to decline, falling another 22%. Finally, in 2003, we closed our downtown music store, and pulled music from two other stores, leaving only one music store left in our chain. The student market has dwindled to a trickle. We don't merchandise to them, we don't advertise to them. What was once the cornerstone of the music buying public has now almost completely disappeared. They aren't buying music physically or online from Amazon, or Best Buy, or iTunes, or Rhapsody, or anywhere else – relative to what they are stealing online. Nobody can really compete with free. I don't care how big you are.

The following is a chart of our music sales from 1999-2003.

Mike's Video, Inc. Music Sales 1999 through 2003

Year	State College Stores Combined	Downtown State College Store	Blacksburg VA Store	All Stores Combined
1999	$2,573,109	$1,263,362	$541,639	$3,114,748
2000	$2,403,891	$977,993	$423,329	$2,827,220
Difference	($169,218)	($285,369)	($118,310)	($287,528)
% Decrease	-6.58%	-22.59%	-21.84%	-9.23%
2001	$1,821,586	$717,652	Sold store 2/1/2001	$1,821,586
vs 2000	($582,305)	($260,341)		($1,005,634)
% Decrease	-24.22%	-26.62%		-35.57%
vs 1999	($751,523)	($545,710)		($1,293,162)
% Decrease	-29.21%	-43.20%		-41.52%
2002	$1,415,246	$632,837		$1,415,246
vs 2001	($406,340)	($84,815)		($406,340)
% Decrease	-22.31%	-11.82%		-22.31%
vs 1999	($1,157,863)	($630,525)		($1,699,502)
% Decrease	-45.00%	-49.91%		-54.56%
2003 (forecast)	$750,000	$135,000 (closed in May 03)		$750,000
vs 2002	($665,246)			($665,246)
% Decrease	-47.01%			-47.01%
vs 1999	($1,823,109)			($2,364,748)
% Decrease	-70.85%			-75.92%

As you can see, Mike's Movies and Music will sell $1.8 million dollars less music in 2003 versus 1999, a 70% reduction in sales. Because of that, the State of Pennsylvania will lose $108,000 in sales tax revenue. Twelve music related jobs; from buyers to store managers and clerks have been eliminated at Mike's. Wages were frozen throughout the company as we struggled to overcome the revenue loss. We were forced to sell our corporate offices and relocate to makeshift offices in various stores. Major capital expenditures have been delayed. Advertising has been cut back. Travel and organizational dues eliminated. P2P services that exist for the purpose of stealing music and movies have decimated small businesses around the country. Small businesses that make America work.

Three years after the first sign of the effects of online thievery appeared, hundreds of stores just like mine are gone or still struggling to stay alive, while at the same time struggling with the public suggestion that file stealing is ok, and no victims lie in it's wake. In fact, the future looks even bleaker as another mainstay of my business, movie rentals and sales, become the next battleground. We have conversations with customers who comment about their "ownership" of downloaded movies. Our student-oriented store in downtown State College has seen revenue decrease by double digits, while stores outside the student influence increase.

In 2003, because of enforcement and deterrence efforts, I can finally say people are starting to get it. Penn State for example, has begun a process to monitor and punish excessive file stealing. The "category 5" level of destruction left upon the landscape of the music industry and approaching the movie industry has people like yourselves and organizations like the RIAA and Penn State searching for answers. It has been allowed to continue without fear of repercussion for too long. The lawsuits recently filed by the RIAA are timely and, unfortunately, a required addition to the educational approach used for the past couple of years. Without that deterrent, as has been proven in my little corner of the world, things will only get worse. I am living proof.

People have no more right, no more entitlement to steal music or movies or any other copyrighted product in a digital form then they do in a physical world. The same rules apply. The RIAA is just enforcing them. I prosecute shoplifters in my stores. If I didn't, and word got out, I would have no inventory. Online shoplifting will only be stopped by aggressive enforcement that creates a deterrent effect. Please help the copyright owners protect their property. Our industries depend on it. My employees and their families depend on it as well.

Thank you.

Mike Negra
President
Mike's Video, Inc.

Statement of Mr. Alan Morris
Executive Vice President, Sharman Networks Limited
Before the Senate Permanent Subcommittee on Investigations
Regarding
"Privacy & Piracy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry"
Washington, DC
September 30, 2003

Chairman Coleman and Members of the Subcommittee:

I thank you for this opportunity to express the views of Sharman Networks Limited (SNL) on the online digital content market today and the important role of peer-to-peer (P2P) in this market's successful future. It is a pleasure to be here today with our Joint Enterprise Partner, Altnet, to articulate our plan co-created and designed to meet the needs of both content owners and consumers.

We applaud your efforts to investigate constructive ways to resolve the differences between the entertainment industry and companies like ours. We appreciate your enthusiasm and attention to these issues here and now, as it is our firm belief that both sides can and should be working together in the near future.

I am Sharman's Executive Vice President, responsible for supervising the enterprise from London whilst our Sydney headquarters is offline at night. I also have specific responsibility for developing the promotion and distribution of licensed content in conjunction with Altnet whose secure rights managed service is integrated into the Kazaa Media Desktop (KMD) software and makes secure authorized content available to each and every Kazaa user. Altnet is the world's largest distributor of licensed and protected media files, and is the leading purveyor of files utilizing Microsoft Windows Media digital rights management (DRM) technology due to our mutual efforts to build an online distribution solution.

Embracing P2P for the Benefit of All Stakeholders

We are here today to discuss not only the future of this market but the current reckless events driven by parties led by the RIAA who could better spend their efforts making a responsible contribution to these future solutions. We want to discuss the impact of their actions on consumers, and their misguided approaches to the very important need to address copyright infringement.

We do not believe that there is anyone in this room in opposition to a vibrant technology solution that protects copyright and sells products. We all agree that digital content delivery is not only here to stay but is the way of the future.

Where we differ is in the means to that end.

What we have witnessed in the recent RIAA litigation against consumers can only be considered a backward step in a market that is growing with rapid momentum. The market is not wayward – reactionary protectionism is. Though we have before us an effective means to influence consumers, we are seeing those same consumers overpowered by the RIAA's legal assaults. This may well cause a counterproductive backlash likely to damage those the RIAA's litigation purports to benefit most – artists and creators.

The issue of copyright infringement is serious and legitimate. Whilst we cannot control the behavior of our customers, we have been committed since day one to working with the entertainment industry and with our customers to find solutions to this dilemma. But, we believe the legal attack on individuals and technology providers on the grounds of protecting copyrights is really just a smokescreen to hide the real challenge confronting the entertainment industry – moving beyond an outdated economic model that is being rejected by the marketplace to a model for which we have a well conceived upgrade path.

Increasingly, the entertainment industry is being widely criticized for not responding to consumer demands and being unable to keep pace with new technologies entering the marketplace. In a *New York Times* article on September 19th, reporter Amy Harmon noted that "the record industry's lawsuits appear to be spurring increasingly sharp debates about how the balance between the rights of copyright holders and those of copyright users should be redefined for a digital age."

She quotes a physician, Dr. Steve Vaughan, 35, who has downloaded about 2,000 songs, which sums up the industry's dilemma nicely: "If they gave me a full selection, and I could sample what I want and it was well organized, I would love that. I'm not doing this to save money. I'm doing this because the music industry doesn't give me what I want." Whether it's a drastically overpriced CD or a poorly constructed online music service, the industry is not delivering the goods and services their customers require.

There is a clear path out of this dilemma for the entertainment industry – a path to win back customer loyalty and market share. Embracing peer-to-peer technology and creating a fair market for the licensing of its content will lead the entertainment industry down this path and back into consumer's hearts, minds and pocketbooks.

This is what Sharman & Altnet have been working towards tirelessly for the last 18 months - to develop and prove out a business model focused on delivering a compelling rights managed offering that responds to the preferences of 21st century consumers. We believe we have co-created a plan that is not only a working solution today, delivering beneficial results to those who have already adopted the model, but that addresses the longer range future for the entertainment industry, enabling them to move forward and embrace a market driven opportunity.

We are poised to take advantage of the market demand for this new model. Kazaa Media Desktop was created to respond to the very consumer demands expressed by Dr. Vaughan -- to enable users to reach across the Internet to search, buy, and share a wide range of digital content online through one simple, reliable and easy-to-use application. Our tens of millions of users are living proof that consumers have tried file sharing, and found it to be a preferred way to access, purchase and share content. But, sadly the major music labels have rejected every approach we have made to them to license their content and to deliver it to users of the Kazaa Media Desktop.

Consumer Privacy Rights

There is another issue at hand here, and that is the delicate subject of privacy—a matter of continued debate among users of the Internet everywhere, and one that is clearly raised by the RIAA's recent legal action against P2P users. We believe that the basic principles of privacy protection should remain intact for everyone, whether in the real or virtual world. Sharman takes privacy seriously, and has worked tirelessly to enhance the privacy protections afforded to KMD software users by according them enhanced control over third parties' viewing of their shared folder's contents, and the ability to block unwanted instant messaging, as well as by altering the user interface to make unintended sharing of personal information much less likely to occur.

People from industry, academia and the consumers themselves are talking about how the RIAA actions have crossed the line. It is not only the backward thinking of the industry that is being widely criticized, but also the 'back door' approach they have taken pursuing their goals. Their total lack of respect and regard for the accepted principles of user privacy on the Internet demonstrates their total disdain and lack of respect for the modern Internet user's habits and practices.

In a recent article in St Louis Post-Dispatch, Selim Bongol of SBC comments "We think the standards that they're (the content industry) using here are so incredibly low to obtain personal information on people that it's invasion of privacy. It's chipping away at personal privacy and using kind of a meat ax to get at it." And there is collateral damage to other potential benefits. Lawrence Lessig, a professor at Stanford University and an expert on Internet law, said recently on PBS "In combating Internet piracy, we are destroying the opportunity of the Internet to serve as a tool for extraordinary creativity and innovation."

Privacy is critical for Internet applications to protect consumers from viruses, spammers, stalkers, identity thieves and other entities that would misuse the information they collect. However, there remains a degree of openness to the Internet that allows law enforcement to use additional powers to determine the real identity of an Internet user by requesting that an ISP disclose the identity of a user behind an IP number at a certain time. It is critical that this aspect of the Internet is not so abused that users of Internet software seek to hide their identity to protect their basic right to privacy. Driving masses of consumers onto private, encrypted, and anonymous networks will create a virtual ecosystem much to the liking and benefit of criminals such as child pornographers, terrorists, and others seeking to operate covertly.

Using companies such as Overpeer, Vidius and MediaDefender to hack into applications like Kazaa to distort its intended purpose, send spoof files to users and even look into users' folders, is only once removed from the malicious actions of other hackers who employ the same practices.

Clearly, we must draw a line that takes account of the benefits of this evolving technology, users' adoption of it, and content owner's need to reasonably monetize it to ensure a thriving new market – a line that preserves privacy and due process. Indeed, Senator Brownback last week voiced the concerns of many across the world when he said; *'Due process, if it existed within the DMCA subpoena process, would provide accused pirates identified through the subpoena with the critical opportunity to rebut accusations of piracy and prevent the release of their identifying information to accusers.'*

Striking the Proper Balance

So the question we raise is: Why can't we strike a balance between the rights of users to privacy, the rights of technology to develop and grow, and the rights of artists and content holders to be rewarded?

We believe a balance can, and must, be reached to protect the rights of all. So, we have taken the following steps to help drive this process in an open minded, collaborative and forward thinking manner.

The current version of Kazaa, combined with the Altnet technology, creates a solution for an efficient, user-friendly way to sell and market content. It addresses two requirements critical to achieving the goal of monetizing an active market and diminishing piracy:

- An end to end technical solution that prioritizes and promotes rights managed content
- Active consumer education and marketing

Here is how the combined KMD and Altnet technologies address these factors:

1. The Kazaa product interface is designed and organized in a way that users like and find efficient, enabling the functions of seek, find, purchase, download, store, and share to be easily employed.

2. Altnet's DRM technology wraps a file, making it secure the first time it is downloaded by a consumer and every other time a different consumer downloads it from a fellow peer. Importantly, it also enables the content holder to define the terms of sale to the user.

3. Altnet's "TopSearch" technology ensures that, in response to a search, rights managed content is delivered in priority order within the Kazaa interface, ensuring that the user will always see rights managed content (if the content holder has licensed its distribution) before any other content.

4. Altnet's Peer Points Manager technology enables Altnet to reward users for sharing rights managed content and thereby encourage users of the KMD to share additional rights managed content. Additionally, by rewarding users with points which can be used to purchase more rights managed content, the system promotes loyalty and more active purchasing.

5. Altnet's payment gateway provides content holders with a means to sell content on a micro-payment basis using credit cards.

Kazaa and Altnet have combined this approach with promotional and marketing initiatives to achieve user focus on official content such as:

- *Kazaa Showcase*, the premium promotional space within the product dedicated to rights managed content promotion.

- *Kazaa Channels* – Areas within Kazaa that a consumer can visit for an immersive experience in their chosen category. These Channels, such as Russell Simmons Hip Hop; One Love Reggae, featuring Bob Marley; and various computer games, ring tones and software application Channels, give users the option to enjoy content on a subscription basis as well as a pay-per-piece option, thus presenting the content industry with two separate revenue models within the Kazaa interface.

Importantly, our DRM solution is designed not only to *encourage* consumers to pay for licensed content; it is designed to *discourage* users from downloading unauthorized copyrighted materials for free.

We believe that if peer-to-peer users are presented quality, rights managed, original works for downloading at a reasonable price to be paid to the copyright owners, if

meaningful incentives are offered for those purchases, and if these products are well marketed, wrongful conduct will diminish dramatically and the availability of infringing files will be suppressed. Our marketing programs are designed to reinforce this solution further.

But, this solution requires fair market licenses from the music industry and at the time of writing this statement those licenses are not forthcoming.

P2P Benefits for Content Holders

P2P delivers many benefits to content holders in its current form, and will continue to as the model advances:

- DRM licensing is flexible and terms of sale can be entirely governed by the rights holder

- Peer-to-peer enables content holders to harness the power of 'viral marketing,' a phenomena virtually non-existent outside the on-line world. The impact of consumers promoting to other consumers can not only enhance a product's success but can deliver significant reductions in marketing budgets.

- Peer-to-peer offers tremendous distribution cost efficiencies, since the users assume these storage and bandwidth costs directly; such costs are negligible to the consumer, as sharing a file requires no more hard drive space and consumers paying for 24/7 'always on' broadband connectivity tend to use only a small portion of that capacity. This makes promotional campaigns and video extremely cost effective -- as evidenced in such Kazaa/Altnet success stories as Tony Hawks' very successful Huckjam tour; artists like Barrington Levy gaining widespread popularity in other countries; and innovative product deals like Ice T's CD album promotion.

- Content holders can acquire important insight into user response to products and adapt offerings and promotions cost effectively.

- New bands, artists and directors can access a user market at low costs and build popularity before partnering with a record label or studio.

Despite the lack of support from the content industry and the persistence of their legal advisors in preventing them from capitalizing on the P2P phenomena, Sharman and Altnet have been able to prove out our model by working in cooperation with content providers ranging from independent artists to worldwide videogame publishers to international movie producers. Sharman has distributed and promoted content from independent music labels worldwide over the Internet using peer-to-peer technology and Altnet's digital rights managed solution. Among those who have benefited from our technology are:

1. Cornerband, a company that allows small, local bands worldwide to DRM encode music and make it available on the Internet, which since June 2002 has been distributing music over the KMD. These are bands not signed by any label that are in search of an audience, which the KMD provides. Cornerband's success in using KMD has encouraged other bands to use KMD to dramatically improve their visibility, and allowed some to achieve mainstream prominence.

2. Australian independent recording label 301 Records for its artists, including "The Honey Palace." Music from the band "The Honey Palace" will be digitally wrapped, digitally distributed, and sold on Kazaa for .25¢ a track;

3. Yash Raj Films, Bollywood's (India's) largest producer of feature length movies, which has distributed movie and music trailers and post theatrical release music videos over the KMD.

Through these relationships the Sharman/Altnet joint enterprise has gained tremendous insight into consumer behavior on-line over the past 18 months, and we have equally invested time and energy into understanding and planning the important next phases of our business plan.

The Betamax Doctrine Revisited – And at Grave Risk

Today, as with the VCR in the early Eighties, a new technology has emerged that affords consumer a way to acquire and enjoy content. This way is better, faster, cheaper and more convenient than the existing retail channels. However, the entertainment industry chooses not to capitalize on this new technology – because they are not yet in position to control distribution in this channel.

So, to effect control of distribution they resort to their tried and true tactics – demonizing the technology (and those who own it) and, in a sign of true desperation, even demonizing their own customers. They have attacked the P2P industry and their own customers in the courts in the purported name of stopping illegal copyright infringement. They have attempted to smear the P2P industry and scare consumers by making false and misleading claims over bogus security issues and alleged privacy concerns, and have even stooped to making patently false claims that P2P is a major factor in the distribution of illegal pornography.

They are supporting Luddite-like legislation that would ban P2P technology, and that would subject P2P users to the threat of federal prison time for unauthorized sharing of a single media file. These tactics are extreme, and they will not work. Yet among all these fundamentalist actions, they fail to act to mitigate their theoretical losses by providing fair market licenses of their music so P2P applications like Kazaa can extend choices of the exact files the music industry would prefer these users to be using.

In the case of the VCR, when a critical mass of market penetration was achieved, the entertainment companies released licenses and adopted sensible pricing strategies, and ultimately gained control of distribution.

We believe the entertainment industry is attempting to manipulate the same outcome with P2P. Ultimately, the industry lost their ill-advised legal battle against the VCR in the historic Betamax decision. But, ironically, they ended up being the single largest beneficiary of the advent of that important new consumer technology, and of its successor – DVD. Indeed, contrary to the scare stories propagated by the industry two decades ago, TV advertising did not die, broadcast TV did not whither, and the movie industry did not suffer the predations of a technological serial killer.

The clear and unbroken two decades' linkage between the misguided attack upon the VCR, and the Betamax doctrine it spawned, was made clear last week in four powerful amicus briefs filed on behalf of defendants in the MGM v Grokster case now before the Ninth Circuit.

These arguments delineate that there are critical issues at stake in both the judiciary and the legislature as both consider the proper response to the entertainment industry's decision to attack digital technologies rather than embrace them. Any court ruling or legislative action that distorts or erases the bright line of protection accorded to new technologies, like P2P, that are capable of substantial non-infringing uses would result in a crippling of technological innovation and progress and in substantial economic and functionality losses for consumers.

The Betamax doctrine offers simplicity, clarity, predictability and objectivity, and any departure from it would put the fate of new digital breakthroughs at the mercy of a weak standard that would be complex, murky, unpredictable and subjective.

Among the key points made by those amici curiae are the following:

- A brief filed by **forty professors of intellectual property and technology law** notes that the Betamax doctrine "clarifies the boundary between contributory infringement and the evolving doctrine of copyright misuse, which limits the power of copyright owners to obtain an unjustified monopoly over technologies".

They observe, "a capability rule accommodates the fact that uses of a technology may evolve significantly over time...Peer-to-peer technologies, which promise numerous benefits, e.g., relieving network congestion and increasing security and fault tolerance, are still in early development. Uses of these technologies will not evolve over time if progress in this field is stymied by expansive secondary liability... *To hold developers of multi-use technologies liable for their customers' infringing uses – even if those uses are the "primary use" at a particular moment in the technology's life cycle – would disserve the public interest in encouraging development of technologies with noninfringing uses... Neither Federal judges or copyright holders should be in charge of industrial design policy for the United States."*

- The **American Library Association, American Association of Law Libraries, American Civil Liberties Union**, and others join to focus on the free speech implications of the present debate.

  They declare that while Grokster "was pled purely as a copyright case, its resolution has obvious implications for the development of free speech on the Internet... *Despite the attempts of both plaintiffs and their amici to argue that this case is not about the abolition of a medium of communication, that is precisely what it is about...* copyright law must be interpreted to preclude the possibility that the development of a new medium of communication could be prohibited simply because it is capable of misuse... at stake in this case is the fundamental issue of whether citizens can be denied valuable technological tools for sharing information and ideas simply because some may use those tools for improper purpose... the law must not be allowed to unduly impede the noninfringing, socially and commercially valuable uses of new powerful technologies."

  They go on to list what may be lost by a wrong judgment that bows to copyright holders' exaggerated fears, noting "the potential for peer-to-peer technology to share information in such areas as medicine, law, and science; to archive historical documents; and to provide economic access to a broad range of public domain information, including government documents." *They also observe that P2P already provides substantial noninfringing uses, reporting, "A mid-September 2003 search of files on Kazaa...revealed that at the time the program was accessed... over 176 million files, for which there is no evidence of infringement, can be accessed using defendants' software."*

The political realm can also benefit from P2P: "As political campaigns move on-line, it is likely that candidates will turn to peer-to-peer technology to distribute position papers and campaign videos... the cost savings of peer-to-peer distribution would clearly make it a superior alternative to other forms of web-based political organizing". They attack plaintiffs' essential argument "that when a technology is used primarily for infringing purposes, the noninfringing speech that also relies on the technology can be sacrificed as collateral damage, regardless of its value". In some cases, this "collateral damage" may be a grievous wound to the yearning for political freedom, as "forcing software companies to incorporate methods to monitor users and choke points to control the flow of information will only make it easier for the governments in China, Saudi Arabia, and other totalitarian regimes to clamp down on speech with which they disagree."

Summing up, they declare that P2P "facilitates pure speech to a greater degree than virtually any other technology available today... Particularly for digital libraries and other entities devoted to public education and the free flow of information, peer-to-peer technology provides the most cost-effective and in some cases the only feasible alternative for accomplishing their mission."

- The joint brief of the **Computer and Communications Industry Association**, and **NetCoalition**, warns of the disastrous result of a denial of Betamax protection to new digital technologies, charging that entertainment industry plaintiffs "seek to change these rules, and replace them with new standards that would give the entertainment industry a veto power over the development of innovative products and services... This misreading would wreck havoc in the information and technology industries, and would harm users of digital information."

  The domino effect of an erroneous judgment is also noted: "But if P2P software distributors have a legal duty to use infringement filters, so do all other software and hardware firms.", including those that provide general purpose computers and their operating systems, Internet web browsers, and e-mail and instant messaging software. Recent Congressional judgments would also be overturned, as "appellants are recasting vicarious liability as a means of requiring IT companies to implement digital rights management ("DRM") systems.

  They are trying to get this court to grant what Congress has already denied." through its inclusion of the "no mandate clause" in the Digital Millennium Copyright Act and its rejection of legislative proposals to have the government mandate copy control technology acceptable to entertainment industry interests. Rejection of mandatory DRM is critical to the preservation of free speech and the inherent balance in copyright law, as, "it is impossible to design a DRM system that can distinguish between fair uses and infringing uses."

They conclude with the declaration that failing to maintain Betamax protection for P2P software "would fundamentally change the character of the IT industry in this country. Instead of a highly innovative and competitive sector, where new products are rushed to market in an effort to satisfy market demand and capture market-share, the IT industry will be regulated by copyright lawyers from the entertainment industry. These lawyers will second guess every engineering decision made by every IT company, and will insist upon DRM systems that limit the many lawful uses recognized by Congress and the courts."

- Finally, the joint brief of the **Consumer Electronics Association and the Home Recording Rights Coalition** begins by declaring, *"The Betamax doctrine stands as the Magna Carta of the technology age" and that plaintiffs' attempt to "eviscerate the Betamax doctrine by imposing numerous limitations on it... would, inexorably, extend the copyright monopoly beyond protected expression to include control over technology... the positions advocated by the MGM appellants and Professors would cause copyright to yield exactly the opposite result than that mandated by Article I, Section 8, clause 8 of the Constitution – it would stifle, rather than promote, 'the progress of Science and the useful Arts'."*

  Consumers would suffer if plaintiffs succeeded in "turning the law of vicarious copyright liability into a more generalized duty on the part of these companies to have the interests of copyright holders rather than consumers uppermost in their minds when making design decisions." *(Emphasis added to all passages above.)*

Necessary Next Steps

With the technology and the business solutions in place, the next steps are two-fold; to acquire widespread copyrighted works to digitally wrap and make available for download and purchase by users of KMD, and to extend current payment methods to make on-line purchasing accessible to the widest possible audience in an easy to use, and enjoyable way.

The first step requires the entertainment industry to move forward at the pace of the market and not try to delay, for whatever reason, this massive opportunity. It must learn from history's successes, not repeat history's mistakes.

The second step requires the involvement of the other players in the integration chain such as telecommunication firms and Internet Service Providers (ISPs), both industries that are already benefiting from the mass adoption of broadband and wireless connectivity that turbo charges P2P technology. Whether this involvement will take the form of negotiated or compulsory licensing, or some combination of both, will be the subject of much debate here and elsewhere.

Conclusion

Sharman and Altnet are proving this commercial solution that can work for the record labels, movie studios, and game makers. The model can be hugely profitable for the entertainment industry. We've invested in the development of the technology and the refinement of the business model. The infrastructure is already in place through Kazaa and other peer-to-peer applications.

But the entertainment industry and the peer-to-peer industry must work together if this dynamic new content distribution model is going to realize its potential. The marketplace is ready for it. Our customers are demanding it. Wouldn't it be better to sell to them rather than sue them?

We eagerly await the chance to hold formal, constructive talks with the entertainment industry to see how we can work together to build the digital distribution model of the future.

Thank you for the opportunity to voice our views today. We applaud the Subcommittee's efforts to help all parties move closer to a peaceful and constructive resolution.

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Testimony of Derek S. Broes
Executive Vice President of Worldwide Operations
Brilliant Digital Entertainment & Altnet, Inc.

Before the Permanent Subcommittee on Investigation

Privacy & Piracy:
The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry

September, 30, 2003

Chairman Coleman, Ranking member Levin, Members of the Committee:

I am Derek Broes, Executive Vice President of Worldwide Operations for Brilliant Digital Entertainment and its subsidiary Altnet. Altnet offers the largest secure commercial platform for the distribution of licensed digital content over peer-to-peer software based applications. Under an exclusive agreement with Sharman Networks Ltd., publishers of the Kazaa Media Desktop peer-to-peer application, Altnet reaches an estimated 75 million worldwide users every month (about twice the reach of America Online). With this reach, Altnet has become the largest distributor of legal rights managed content over the Internet. Altnet takes the issues before this committee very seriously, and, as you will hear in my testimony today, Altnet is leveraging its role as a market leader by spearheading efforts to establish a viable business model for peer-to-peer application providers, content owners and users while at the same time having the highest regard and respect for the rights of each of the parties concerned.

My testimony provides a background to the events leading to the circumstances we are now confronting. It outlines the current activities of Altnet and proposes a very clear sense of direction for the future of content and peer-to-peer in which copyright owners, who may have lost their way, are once again benefiting from the wonders that technologies like peer-to-peer (P2P) deliver.

A brief outline of peer-to-peer

1. Technology is in a constant state of evolution driven by society's general desire for improved efficiency. When distributed computing concepts based around peer-to-peer applications emerged many years ago users began to adopt them because they were more efficient and effective in locating files than anything that had been offered on the internet previously.

2. Broadband access favored user adoption of peer-to-peer because computers functioning together in a synchronized fashion became more powerful in the aggregate. These peer-to-peer applications emerged around 5 years ago when

students at universities discovered that with broadband connectivity they could network their computers by using common protocols, which enabled their computers to communicate with each other via distributed applications known as peer-to-peer or P2P applications.

3. Napster was the first mainstream application that was adopted broadly because it enabled its users to locate and share files with each other. The Napster application architecture was designed to "centrally broker" the connection between each peer computer and to operate as the central index of all files that were available on all Napster enabled computers.

4. During the Napster days, bandwidth prices to ISP's and organizations hosting web sites and web content averaged around $300-$500 / Mbsec. Today bandwidth prices have come down to around $100-$200 / Mbsec or less. Music files are relatively small averaging around 5MB and are therefore not very expensive to distribute. Video and Video Game files are generally much larger than music files, as such they are more expensive (because they take more time to download) to distribute.

5. P2P applications are generally made up of two primary software components: 1) a search index – the ability to find a file a user is looking for on another computer 2) a transport protocol – the way in which the computers connect together to transfer information.

6. Users connected to the Internet, who have a common P2P application, and who have made files (generally in a shared folder) on their PC available, become servers to other common P2P application users. When a computer locates a file it is seeking, it becomes the "downloader" of that file. The computer (or computers) serving the file (or segments of the file) becomes the "uploader".

7. Files located on common P2P enabled computers do not need to be located from a central host and therefore the bandwidth costs normally associated with the distribution of a file are reduced to the central host since the user is already paying for their bandwidth in the form of a monthly fee to their ISP.

8. P2P protocols generally seek multiple sources of the same file when a user makes a request to download a file. The file is generally located on many of the P2P enabled computers. Using a unique (very large) file number called a "file hash" the P2P application identifies multiple P2P party sources so that often the file will be downloaded by 6 or more parties or uploaded by 6 or more parties with each party providing one sixth of the file depending on the file transfer rate of each party.

9. Since many P2P applications, like Kazaa, have millions of users offering files to other users, a myriad of different file types and data are available at any time. In many cases users make up their own files or obtain their files from a large number

of sources including web sites, CD's, DVD's, file servers, newsgroups, emails and other locations accessible via the Internet.

10. Some P2P applications are "open" protocol applications meaning that any file can be made available and transported to any user of that application. Whereas others are "closed" applications only allowing certified or authenticated files to be transported among users of the P2P application.

A brief outline of DRM

11. Digital Rights Management solutions have been available for the past 5 years. Microsoft is one provider of this technology. DRM solutions protect files so that they can be freely distributed around the Internet by anyone who chooses to do so. DRM files retain qualities necessary for copyright owners to invoke and revoke their rights on an individual user basis. DRM files can be distributed via open or closed P2P applications and remain in control of the copyright owner at all times.

12. DRM acts like an umbilical chord attached to the DRM file. DRM provides the underlying security locks around a file and generally an interface that allows a "storefront" to travel with a file regardless of where or how the file gets delivered to a user. Once the user plays the file, the rights management rules are activated and control of the user experience and rights associated with the file are, from that moment on, passed to the copyright owner or the representative of the copyright owner who is operating the DRM license server on their behalf. Users must comply (meaning; the file will not open or play if they do not comply) with the requests of the license (managed by DRM) before they get the right to access the file.

13. Users of open P2P applications are located globally and as such the files that they make available are provided across international borders and are subject to copyright and other laws in each country from which they originate. Files made available in the public domain are generally 'free to distribute' although these are also subject to country-by-country laws and commercial / copyright restrictions. Open P2P applications carry DRM and non-DRM files as well as authorized (non DRM) and un-authorized (non-DRM) files.

Actions of the Music Industry

14. For the past 12 months or more, the RIAA have led a constant stream of organizations to provide services to them and their members. These service providers have hacked applications and broken ranks with accepted rights of privacy on the Internet to spy on user behavior, analyze their files and generally divert intended actions of technology solutions selected and being used by end users. These actions are unprecedented and establish a very dangerous and disturbing precedent. Altnet chose to directly negotiate its rights with P2P application providers like Kazaa in an effort to participate in the

commercialization of P2P applications. The music industries premature "presumed guilty" judgment of P2P providers led it down a narrow litigious path in which they continue to seek counter productive solutions.

15. The music industry has currently adopted a wholesale pricing model to license its files to web sites that retail these files to end users. The five major music labels all provide licenses in a similar fashion charging a wholesale price to the web site retailer. This is a similar structure to the existing terrestrial distribution structure. While music is not very expensive to distribute via P2P, pricing has not yet stabilized, nor has the business model for digital distribution been fully resolved. For example, in the future, music on the Internet may be commercialized using advertising, much like TV. Under these circumstances, reducing the cost of distribution could become an important future requirement for the music industry.

16. Currently the music industry does not permit its DRM licensees to use or benefit from the efficiencies of P2P distribution technologies since they are fighting the very existence of these technologies.

17. Generally the licensees of music content from the major record labels have been required to pay or commit to large advances or promises in order to get access to these licenses. The music industry is selective in the partners that it chooses and through this controls the technologies that those partners embrace.

18. The wholesale on-line model used by the music industry resembles its terrestrial model, but the music industry does not leverage its terrestrial distribution partners by making them pay advances or obtain licenses for the right to sell products that they provide, nor do they restrict the technologies or the methods that terrestrial retailers and wholesalers use to sell music.

An evolving Internet and its relation to Copyright

19. The Internet is evolving. Technology on the Internet is used in a number of different ways to improve efficiency and experience. P2P is not unlike other technologies currently in use by web sites, content providers and search index operators on the Internet. Google, Yahoo, MSN, AOL and others provide search engines to users who are seeking to locate content at web sites.

20. Microsoft provides one of a number of transport protocols to all users via its Internet Explorer browser. This protocol is generally known as HTTP. Central search engines like Google connect users to web sites at host servers all over the world. Many of these web sites provide infringing and unauthorized material for users to load onto their computers when Google connects users to that web site. Sites offering un-authorized content to Goolge users are subject to copyright laws and legislation in each country in which they are located.

21. In the case of P2P applications like Grokster, Morpheus and Kazaa, their distributed transport and search protocols are known as Fasttrack and Gnutella – these are comparable protocols to HTTP or FTP (another web standard protocol). These applications connect users to content they are seeking (via their search index component) and they transport the content via their protocol in much the same way HTTP works with search sites like Google.

22. Searching the term "Eminem" on Google connects users to more than 3 million web sites at hosts in countries all over the world. The vast majority of these sites are unauthorized sites and offer unauthorized and infringing content in the form of image files called .gifs and .jpegs as well as mp3's and other illegal or unauthorized video files. Users who access these sites duplicate this content from the host server (uploader) to their computer (downloader).

23. In the USA, the Digital Millennium Copyright Act (DMCA) provides protection to parties like Google who have immunity under the law from any immediate claim that a copyright owner may have over them. DMCA requires copyright owners to "notify" web sites, hosts or ISP's allowing them time to respond in an appropriate manner before copyright owners have the right to act to protect their rights.

24. Clearly copyright and technology on the Internet is a complex maze of intertwined issues that make any outcome very difficult to determine. This is made even more complex by the international use of P2P and other host technologies. The use of technology is ultimately in the hands of the user. The behavior of the user is clearly one which is at the root cause of many breaches of copyright.

25. Users have and will continue to embrace technologies that improve efficiency and experience. P2P is one of these technologies. The music industry has failed to respond to build business models at the same rate that users have switched their music distribution preferences. Consumers worldwide have embraced the new distribution methods available to them through the use of their broadband connections for which they pay a hefty monthly fee. While many users still connect to the Internet via narrowband, the most active user base in the mainstream is now broadband enabled.

Altnet's participation – A business model reliant on support.

26. Altnet is P2P platform developed to interoperate with other P2P applications and transport protocols to deliver authorized content. Altnet provides a search engine (TopSearch) as well as a P2P transport protocol to users who wish to access its content. In addition Altnet runs a loyalty points program ("Peer Points") for its users encouraging and motivating them to select authorized content in place of unauthorized content when using open P2P applications like Kazaa. Altnet has entered a productive dialogue with other operators of P2P applications worldwide

and has entered into distribution deals with these commercial application providers encouraging them to provide improved visibility of authorized content to users of their applications.

27. Altnet's most successful partnership to-date is with Shraman Networks Ltd., the provider of the Kazaa application. Each time a Kazaa user selects and pays for an authorized content file, Altnet manages the transaction through its DRM technologies and its payment gateway and provides a share of the gross margin from that purchase back to Sharman Networks. This commercial relationship encourages P2P application providers to program their applications to prioritize the order in which search results are displayed such that the authorized content receives more prominent exposure and has a greater chance of being selected by users of the application.

28. P2P is already getting support by many copyright owners: Altnet content providers include companies like; Ras Records, Lionsgate Films, Cornerband, I-film, and Microsoft, Artists and bands like; Ice-T, Barrington Levy, Little Feat, Prodigy, Lynyrd Skynyrd and Public Enemy, Video game providers like; Atari, Eidos, 3DO, Team 17, and Titus, and Channel operators and Producers like; Zalman King, Russell Simmons, Stan Lathan and Lee Jaffe.

29. Recently Altnet entered into a promotional deal with Streamwaves, a licensee of more than 250,000 music files from each of the major music labels. Streamwaves has been promoting these files on web sites like Google, Yahoo and MSN. Now Streamwaves are working with Altnet and indirectly Sharman Networks to promote authorized content to Kazaa users. Since this is an indirect relationship, files provided by Streamwaves are restricted and cannot be delivered to P2P users in the same "user friendly" manner that other files are provided by Altnet and its P2P partners. In the absence of a distribution license from the major record labels, Altnet is forced to promote Streamwaves content with a handicap that other licensees of this content do not have to contend with.

30. Altnet has approached the major music labels individually on numerous occasions to license content directly and has not been successful in its attempts over the past 12 months. Until the music industry, under guidance from the RIAA and the attorneys in the lawsuit against P2P operators, recognizes and authorizes the use of P2P technology for the distribution of music files, Altnet and Streamwaves will be unable to offer users of P2P applications like Kazaa the benefits of efficiency and convenience that these applications provide.

31. The litigious attitude displayed by the music industry through the RIAA has created a large difference of opinion between the providers of P2P applications and the music industry, making it difficult for these parties to come to terms with each other's point of view.

32. Altnet has been working diligently to bridge the divide and has recently joined the Distributed Computing Industry Association to help establish a forum where the views of technology providers and content owners can be articulated in the interest of establishing harmonious relationships in which new business advantages from the ever increasing pace of technological change can develop.

33. Clearly P2P technology should be allowed to develop un-impeded. P2P Technology should continue to receive the same benefits afforded to free speech under the constitution that other technologies such as the Internet receive. This is a technology that is at its early stages of evolution. It will grow to improve the efficiency of the internet because it enables much larger files to be put into circulation supported by business models that require lower cost distribution solutions. Artists and creators of copyright works worldwide are already able to use P2P to place their works into circulation without having to pay for the higher cost of hosting or serving and therefore many up-and-coming musicians and filmmakers are beginning to experience the benefits of this technology already.

A model for the future of Music

34. The music industry is fighting their own shadow. Technology when embraced has rarely been detrimental to the content industry. Over the last 100 years, every new form of entertainment transmission or distribution has resulted in industry growth in larger-than-anticipated amounts. While technology impacts the economics of an industry in a number of different ways, the efficiency gains, in most cases, improves the economic outcome in the medium to longer term. The music business has operated around a premise that is exactly opposite to this notion.

35. Listening to users, it is clear that efficiency (representing convenience) is a key factor to adoption. Of the various services that the music industry has licensed, Apple's i-tunes has shown the most promise. This is occurring for a number of reasons including the fact that Apple has made it extremely easy for users to pay once they have registered with their credit cards.

36. Altnet is working with a number of payment processing providers and believes that this continued effort is critical to increasing the percentages of users who would be willing to pay for content by making it more convenient and more fun for people to pay. With this in mind, Altnet believes it is very important to improve payment methods. In order for it to achieve these objectives, it will require support not only from content owners, but from Telco's and ISP's.

37. While the music industry must be held accountable for their dramatic and reckless actions, Telco's and ISP's have been direct beneficiaries of copyright abuse through their growing DSL, ADSL and broadband cable subscriptions. They are the ones that are expanding their business at a time when the music industry

appears to be in a state of panic about its shrinking margins. They must stand up, be counted and positively engage in working toward the solution.

38. The music industry business model of the future requires that these parties begin a process of cooperation in order to affect a change that will lead to a highly profitable web based content on demand marketplace that is ordered by rules and laws that support the behavior of their common customers. This model, while easy to articulate in detail, is encumbered by a antagonistic environment and lack of business vision.

39. In order to move on and turn this fiasco into a money making, healthy capital generating sub-economy, labels, Telco's and ISP's must cooperate in a synchronized and coordinated fashion toward a common goal. The goal is clearly to ensure that license holders are paid, that users can feel free to adopt new habits and the technologies of their choice and that working together, a new and powerful distribution system can prosper.

The business model of the future for the music industry is complex, but a staged solution can be found - that solution is already underway. The model is one in which more revenue by way of contribution margin is returned to the overall music economy than is currently the case. In order to achieve this, I believe that the playing field must be leveled. I believe that content owners, Telco's and ISP's need to join together to tackle this issue once and for all, but I also believe that legislators have a role to play in creating the conditions under which these cross industry agreements can be negotiated.

A detailed business model for the future of the music industry is available on request. For more information on this, contact Marty Lafferty, chief executive officer of DCIA.

Thank you, Mr. Chairman, for the opportunity to have participated in this most important hearing. We invite any questions that your committee may have.

Derek S. Broes
Executive Vice President of Worldwide Operations
Brilliant Digital Entertainment & Altnet, Inc.

Testimony of Chris Gladwin
Founder and Chief Operating Officer
MusicNow

U.S. Senate Subcommittee on Governmental Affairs
Permanent Subcommittee on Investigations

September 30, 2003 Hearing on
Privacy & Piracy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry

Good morning. I am Chris Gladwin, Founder and Chief Operating Officer of FullAudio, Inc., the company behind the MusicNow digital music service. I'd like to thank Chairman Norm Coleman, Senator Carl Levin for scheduling this hearing to address issues that are affecting the future of our culture, creativity, innovation and citizenship.

I started MusicNow five years ago with the purpose of creating an Internet-based music service that would improve the way people explore, enjoy and purchase music. Unlike many digital music services that you may be aware of, MusicNow is an independent company, created and funded without any financial support from recording labels or traditional music industry executives. Thus, my testimony today is certainly not the voice of an "industry insider", but rather is the voice of an entrepreneur, music fan, and consumer advocate.

Business is Hard; Competing Against the Black Market is Harder.
During our five years, we've worked through many difficult issues with major labels and music publishers to help create the first licenses for interactive music services. As important, we have been a test bed – developing and redeveloping and marketing and re-marketing an innovative royalty-paying commercial digital music service that consumers are willing to pay for.

We always expected that the record labels and music publishers would be challenging business partners, and we understood that Congress would need to modernize the copyright laws before our service could be its best. But we never expected to be challenged by competition from black market networks that intentionally confuse consumers about intellectual property rights, that take money and make money from music fans without compensating creators, and that seem only to thrive in the absence of aggressive federal law enforcement.

Law Enforcement, Education and Promotion of Legal Services are Needed.
In this challenging environment MusicNow absolutely supports the recording industry's aggressive action in defense of its intellectual property, and we think Congress should also be supportive, and should promote more federal enforcement of the copyright laws.

MusicNow would also support a significantly greater effort by the private sector and government to educate consumers who generally do not understood (or perhaps just do not adequately respect) intellectual property. And finally, MusicNow calls on the record labels, the music publishers, and our legal online music service partners to create a massive marketing campaign to educate consumers that legal online music alternatives exist, they are of a high-quality and getting better, they are fairly-priced, and they don't come with subpoenas.

Copyright Laws are Outdated, but Compulsory Licenses are Not Needed.

Other witnesses will testify today that the copyright laws and music licensing laws are so outdated and that Congress is so inept at keeping up with technology and consumer behavior, that the only reasonable alternative is a compulsory or statutory license that strips from creators their ability to manage their own business – that of licensing the use and distribution of their creative works.

MusicNow believes otherwise – that although Congress needs to modernize certain copyright laws and reduce the complexities that prevent MusicNow and others from maximizing royalty payments and competing more aggressively with black market networks – the basic foundation of copyright law is sound. And though some of the rights and technologies behind Internet music are complex and create uncertainties, those complexities should not cloud the reality of how our industries collectively must progress in a legitimate manner.

Other witnesses will also tell you that the record labels have violated the antitrust laws and failed to license disfavored companies with rights that have been maintained for their own preferred providers (that are often joint ventures or portfolio investments of the labels).

I will tell you a different story: that (a) the recording companies have been slow to recognize the extraordinary sea change in technology and consumer behavior; (b) that the recording companies tried hard for several years – and for all the correct (albeit unfortunate) business reasons – to control the future of technology and consumer behavior; and (c) that as a result the recording companies were excruciatingly difficult to negotiate with and partner with at a time when MusicNow and several legitimate companies were trying to help them reach consumers with viable commercial royalty-generating products and services.

But speaking as one independently-funded music service provider who is in today's marketplace, those issues are yesterday's news. Today's news is that several independent companies are being licensed on much more reasonable terms, and with the ability to offer more innovative, consumer-friendly services. Apple, RealNetworks, the new Napster, MusicMatch, BuyMusic.com, AOL, Dell and Amazon.com are all competing with MusicNow or soon will be, and we welcome the competition.

I have no sympathy for the frustrations of black market networks that are aggregating so-called customers by offering illegitimate access to pirated music and movies. Contrary to

the statements of black market network operators, it is possible – though not easy – to license from record companies and publishers the rights necessary to operate a legitimate digital music service. MusicNow and several competitors have licensed interactive digital distribution rights from all five major recording companies and from the major music publishers, as well as from several independent record labels and publishers. We also have licenses for subscription-based Internet radio and licenses for cover art and song samples (for promotional uses).

Using these licenses, MusicNow has developed an Internet-based music service that enables our members to play music on demand, to play Internet radio stations, to subscribe to music that has limited rights (e.g., it is only useful for 30 days or on the consumer's PC), and to buy music that can be burned onto a CD or transferred to a portable device such as an MP3 player. We are also adding a music download store that will allow shoppers to purchase digital music without paying a monthly fee.

Let me be very clear, Mr. Chairman, black market networking companies that complain today that they haven't received licenses from music owners haven't worked hard enough to create sensible business models, nor to establish themselves as reputable business partners by not facilitating piracy.

RIAA Antipiracy Efforts Must Be Strengthened, Supported and Broadened.

Another issue raised by this Subcommittee and by consumer advocates is whether the RIAA's anti-piracy enforcement efforts have been over-aggressive or anti-consumer. To the contrary, Mr. Chairman, I propose that your concern should instead be whether the RIAA's enforcement effort may be too little and too late; whether it is adequately supported by federal law enforcement; and whether the rest of the anti-piracy campaign – focusing on public education and promotion of legal royalty-paying alternatives – is sufficient; and how Congress can modernize copyright laws in support of legal services so that consumers have the best possible legal music services available when a comprehensive anti-piracy effort succeeds.

News reports suggest that the RIAA has issued several thousand subpoenas aimed at identifying consumers who unlawfully utilize black market networks to distribute copyrighted music, and that 261 of these consumers have been sued. In contrast, last year more 12,000 consumers were sued by DirectTV for unlawfully accessing satellite television service. I suggest that the RIAA has been too restrained for too long, and that this lax enforcement combined with too little focus on public education and painfully slow licensing of legitimate services created a marketplace vacuum that was filled by black market networks. I would urge more enforcement by the RIAA, and more enforcement by the federal government.

Specifically, Mr. Chairman, MusicNow supports the efforts of Chairman Lamar Smith and Ranking Democrat Howard Berman of the House Subcommittee on Courts, the Internet and Intellectual Property. Later this week we expect the Subcommittee will consider H.R. 2517, the Piracy and Deterrence Education Act of 2003, and though we hope that specific provisions are modified we support this bill's goal of promoting more

federal enforcement and more anti-piracy coordination between government and private interests. MusicNow also specifically supports the increased funding for federal enforcement that has been proposed by Representatives John Conyers and Howard Berman in H.R. 2752, the Author, Consumer, and Computer Owner Protection and Security Act of 2003.

Public Education about Copyright, Creativity and the Law is Essential.
Enforcement is valuable for its specific deterrence of bad behavior, but it is perhaps more important as a public education tool. Additionally, however, in order to reduce piracy to a manageable level, we need more tools and more resources for public education.

Many consumers are legitimately confused by the apparently unfettered presence of black market networks, some of which even charge for premium access to their so-called service. More consumers do not understand how easy it is to be caught and perhaps sued or apprehended, as their Internet activity can be tracked by law enforcement and rights owners. Virtually all consumers are completely unaware of who is harmed by their behavior, and how our collective respect for intellectual property is critically important to America's information economy.

Over the course of thirty years our public schools and media providers have significantly expanded their socially-oriented public education efforts. In school and in the media there exist curricula and advertisements that promote healthy behavior, healthy eating, and environmentally-sound behavior. Complex problems such as cigarette smoking, littering, homelessness and pre-marital sex have been addressed in different ways to different audiences in schools and in the media.

Consumers intuitively understand that taking valuable products or services without permission or payment is generally wrong, but this must be reinforced with education about the harms to their community, their neighbors, and to America. As a society that supports innovation and creativity, we must ensure that in the future our children appreciate authors, scientists, songwriters, recording artists and movie producers, and recognize the harms associated with stealing even that which appears easy to steal. In this regard, I hope this Committee will praise the motion picture industry for its partnership with Junior Achievment that is developing age-appropriate intellectual property education curriculum for middle school students.

First, the public needs to clearly understand that so-called (quote) "sharing" of music is stealing and it is wrong and it will be prosecuted. Second, the public needs to be aware that several legal alternatives exist for acquiring digital music. We call on the RIAA, Congress, music companies, musicians and the press to at least match the attention they've given to black market networks with an equal level of attention and support for legal services.

Strong, Well-Promoted Legitimate Services Can Defeat Piracy in the Market. Finally, there is the linchpin of anti-piracy success – the existence, improvement, attractiveness and success of legitimate digital music services that will win consumers in the marketplace. Because we all know that marketplace success requires a high-quality, fairly-priced, comprehensive service with all or almost all of the music that consumers want, and that scaring consumers with enforcement and education without offering high-quality legal alternatives is a losing proposition, and anti-American.

Promote Legal Services. First, I urge the recording industry and music publishers to more aggressively promote legal services. Don't just license us and take our advances against future royalties – utilize all of your marketing muscle and artist relations and traditional know-how to promote legal online services to consumers who we all believe would generally prefer to be legal. Here are a few ideas:

1. Full-page ads in newspapers should read "Don't get sued; get legal", and tell consumers about MusicNow and MusicMatch and RealNetworks' Rhapsody and Apple and all our competitors.
2. If record labels want nascent independent music services to succeed, provide co-op advertising and marketing support just as has been traditionally been offered to traditional CD stores.
3. License 30-second promotional song samples royalty-free to legitimate music services that are true partners, and that are helping defeat black market networks.

More Artist Involvement. Second, recording artists and record labels cannot let their differences over contracts and health care and labor laws bleed into the issue where we all must stand together – against piracy, against black market networks and in support of royalty-paying legitimate services. Recording artists are the music industry's connection to music fans, and their voices must be part of this effort.

Congress Must Modernize Copyright Laws. Third, Congress must do its part. As part of its anti-piracy agenda the Congress must address means of ensuring that outdated laws do not inhibit legitimate digital music services from reaching our potential. The Copyright Act was developed to support creators and consumers in bygone eras of player pianos, vinyl records and CDs. Today that same Copyright Act is limiting our success, and indirectly supporting black market networks.

Two years ago the U.S. Copyright Office reported to Congress suggesting changes in copyright law that are needed if digital online music services are to reach their potential. The House has held hearings on this report but not yet acted. The Senate has not even held hearings or otherwise acknowledged the Report's existence. We urge the Congres to immediately consider the recommendations of the Register of Copyrights, and to work with all stakeholders to modernize our laws and benefit consumers, creators and digital music services.

Additionally, I understand that some Senators are considering legislation that would eliminate sales and use taxes on legitimate digital music and media services. MusicNow would support this wholeheartedly.

* * * * *

MusicNow and our legitimate Internet music competitors have built great services, through which we play and sell hundreds of thousands of songs to music fans and properly pay record labels, publishers, recording artists, musicians and songwriters. Collectively we have several hundred thousand paying customers, who demonstrate daily that there are viable alternatives to stealing digital music.

I believe in the inherent ethics of the American people and we prove that every day by signing up paying customers. However, in order for the United States to enjoy the benefits of our cultural creators and of vibrant and healthy digital media industries in the 21st century, we must be able to establish and enforce property rights for digital media just as we did for manufactured goods in the 20th century.

To ensure that, MusicNow supports a comprehensive, aggressive, adequately-resourced anti-piracy effort. This requires private-sector and public law enforcement, public and consumer education, and continuing improvement and promotion of legitimate marketplace online music services. In addition the RIAA's role, which we appreciate and support, we urge Congress to continue its oversight, promote law enforcement, and modernize copyright laws.

Thank you.

MusicNow (also known as FullAudio) – Background Information

MusicNow is a leading provider of personal music services that deliver the best in digital music content from industry leading record labels and other content providers. Our pioneering music services enable our partners to sell music downloads and subscriptions seamlessly. For content partners, our platform facilitates the promotion, marketing, and secure distribution of music.

MusicNow is the first music service to establish partnerships with both major record labels and music publishing companies. Because MusicNow believes music content owners should benefit from their works, we have integrated our business infrastructure with the consumer interface to guarantee that artists and publishers receive appropriate royalty payments.

Founded in April 1999, MusicNow (otherwise known as FullAudio Corporation) provides a platform and infrastructure that enables our channel partners to deliver a full spectrum of digital music services to consumers. The company's unique approach allows our partners to quickly expand their relationships with consumers by offering on-demand subscription and music purchase services, such as digital sampling, streaming, webcasting radio stations, and music downloads. MusicNow deploys the software and systems that cover every aspect of music content aggregation and delivery, including content acquisition and management; media storage and secure delivery; digital rights management; and a service infrastructure. The company provides all of the back-office functionality, including billing, reporting and analysis, and usage analysis. MusicNow offers its service through Charter Communications, Clear Channel Communications, EarthLink and Microsoft's Windows Media Player.

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Statement Of

LORRAINE SULLIVAN

Before The

Permanent Subcommittee on Investigations

Hearing On

Privacy & Piracy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry

September 30, 2003

My name is Lorraine Sullivan. On September 9, 2003 I was named in a lawsuit by the Recording Industry Association of America. This is the written testimony of my account.

In August 2001 my fiancé signed up for the Kazaa under the account name Kissiffer4. It was a couple of months later that I began using Kazaa myself for downloading music.

In the first week of August 2003 I was sent a letter by my cable provider Time Warner alerting me to the fact that they had been subpoenaed by the Recording Industry Association of America for my personal information. The letter stated that I was being accused of copyright infringement and Time Warner was being forced to release my information to the RIAA. I immediately called the phone numbers listed for the RIAA and lawyer's representing the RIAA on the copy of the subpoena and was unable to reach anyone at the RIAA. Next I phoned Time Warner customer service and was essentially told that by customer service not to worry about the matter.

I got rid of Kazaa and all the songs on my hard drive as soon as I got off the phone. I thought by doing so I had nothing left to worry about. However, that turned out not to be the case.

On September 9, 2003 I came home to four messages from reporters asking me for statements in response to being sued by the RIAA.

I immediately contacted the RIAA once again. This time I actually reached a person who forwarded my call to Stan Pierre-Louis. After giving him my information he said he would look up my information and get back to me. When Stan called back he explained the case against me. He told me I was being sued for copy right infringement. He advised me to look at a website called "www.musicunited.org" and further advised that if I were still downloading and sharing files I stop immediately. I willingly told him I had gotten rid of Kazaa and all my files as soon as I contacted Time Warner about the letter of subpoena. I asked him why I was being targeted when Kazaa did not have any disclaimer on their website informing me of the logistics of copy right infringement and not only defaulted to sharing files automatically but also was booted up any time my computer was on because I had a cable modem hooked up. He said he could not discuss

that with me since the RIAA were considering or already had entered into litigation with Kazaa. I said that I had read reports that I would be held accountable for $150,000 per song in my "shared folder". He said the charges could range between $750 per song and $150,000. I was pretty emotional by this point and he told me that the goal of the RIAA was "Not to ruin your life and make you bankrupt". I replied that actually it felt like that. I told him it was pretty stressful to hear the news from reporters on my answering machine. He then explained reporters had gotten my personal information from waiting around at the courthouse and looking up the names on file. Next he told me that I would be "served" by hand. When I asked what exactly I was being "served" he explained that it was the summons which I took to mean the documents to be used as the case against me. He detailed that there would be a letter with the summons that would explain how I could settle the case out of court if I wished to do so. I asked what that meant and what it involved. He told me that it would include a settlement in the "low thousands" and that it would probably be worth it to "put it all behind" me and get on with my life. I agreed that dealing with the pressure and stress was scary because a probable million plus debt hanging over my head was pretty horrific. He referred me to Pat Benson and said she was handling the settlements. He mentioned that she was not my attorney and that I should not ask her for advice since she was not working for me.

Next I phoned Pat Benson. I left a message that evening and received a call back from her the next afternoon. She too said that if I were still downloading music I should put a stop to it. I explained to her that I had stopped as soon as I received the Time Warner letter. She further explained that I was being sued for copy right infringement. I asked what a settlement consisted of. She asked if I was interested in settling and I said I was interested in knowing how it worked. She told me that would get papers to sign basically admitting to guilt. Then there would be a mutually agreed upon monetary settlement. I asked what the exact number would be. She told me between three and four thousand. She then said I had probably heard about the 12-year-old who had settled for $2,000 and informed me that that particular case had been a "special case" since Brianna's mother was on public assistance. This particularly upset me because I thought, "Since I worked hard for so many years and waited until my mid-twenties to go to school and am not on public assistance my case is different?" I couldn't understand that implication that our cases were so different and was even more emotionally upset at this point. I then asked if the settlement had to be paid in one lump sum. Pat said yes, it did and that they had considered accepting it incrementally but with so many cases it wouldn't be feasible. I cried at this point and told her that all I had was $1500 in my savings account. I explained that I was a full-time student with a part time job that usually paid less that $150 per week. I also explained that I had taken out student loans but that they had almost all gone to my tuition and school expenses. She asked me if I could ask my parents for money to which I replied no. I said my mother struggles herself financially and I never speak to my father. She asked if there was any one else I could get to help me and I said no. She asked if I had any credit cards and I told her that although I did they were pretty close to their limits but I could inquire about a cash advances. I was crying and saying that this was all pretty stressful and she sympathetically said "Nobody likes having to be the heavy". She said she would go to her clients and see if they would be willing to accept less than $3,500 from me.

Two days later we spoke again and Pat said her clients had agreed to accept $2,500 from me. I thanked her for pleading my financial case to them. I told her that I had come up with $2,100 so far and had some ideas about coming up with the rest. She told me that the paperwork would be sent out and I would have a couple of days to look it over and send it back with a certified check. I asked how many more days I would have to get the rest of the settlement money together. She said I should sign the papers and return them within the week. I asked if there was any way I could be sued again after I signed the papers. She told me that she couldn't advise me as I was not her client. Then she answered that theoretically I could be sued but from a practical standpoint I probably would not be. She said she understood that I had a lot of school work that I wasn't doing because of the worry this case had inflicted. She told me not to worry and just to concentrate on school. She also said not to freak out if I got served with the summons in the interim because she would file an injunction and even if I did receive them I had 15 days to reply to them in court. I agreed that when I got the papers I would sign them and send them back as soon as I gathered the full $2500. Pat said to call her if I had any further questions.

I then created a website and ask for help from others who might have found themselves in my situation. I got the idea from doing research about four college students who had run search engines and been sued by the RIAA. On my site I explained that I had no idea I was sharing files and that I was not personally responsible for all the songs downloaded. My sister, her boyfriend and my husband among others have used it also. This website helped me raise a $600 in donations for my settlement.

I did not actually receive the summons until September 18th when they were hand delivered to me at my home address.

I feel that I have been misled as a consumer of music. I do not burn CDs and yet when I go to the store I see Sony sells "writable" discs. I wondered what I was supposed to put on these discs since downloading is supposedly akin to shoplifting music. Also as equaling misleading is the advertising that Sony has on television for their mini-discs. In the commercial you see a blue-headed alien encouraging a couple hundred friends to copy the play list he has created. Is it any wonder why other consumers such as me found, and still continue to find, it all so confusing?

I mistakenly imagined that since Kazaa was still up and running while Napster had been forced to close down that the downloading I was personally responsible for was okay. I certainly never saw any sort of disclaimer on the original Kazaa website. I compared it to recording songs from the radio. I never willingly shared files with other users. I was not even fully aware of all the songs in "my" Kazaa file until I looked at it after receiving the Time Warner subpoena letter. As far as I was concerned the music I downloaded was for home, personal use. I made a play list of favorites and listened to it when I cleaned house or did homework. Part of the reason I downloaded songs I already owned on CD was because I didn't want to mix them manually and found it more convenient to have on my computer. I don't know how to "upload" songs on the

computer either. I in no way financially benefited from nor intended to make a profit from the music I listened to. As far as I was concerned copyright infringement was what he people in Chinatown hawking bootlegged and fake CDs on the street corner were doing. Since being named in the lawsuit I have educated myself pretty quickly. I have taken responsibility for my part in all of this. I realize "I didn't know what I was doing" is not a valid defense.

Still, I am angry with the RIAA for their unfairness in handling these lawsuits. I resent being unfairly targeted and having to choose between paying a settlement I can barely afford or to deal with the worry and stress of litigation with the possible outcome of being held personally responsible for a couple of hundred thousand or millions of dollars in damages. The RIAA's manner of investigating is severely lacking. They do not seem to care how responsible the person listed for the ISP address actually is for the "crime" they're accused of. I find that the most upsetting, that they go through all the trouble make statements to the press about going after the most "egregious" users and then do not follow up on actually researching how egregious each specific user that they are suing is!

I have heard, though I never actually read one that the RIAA sent out instant messages of warnings to people, such as me, who were on Kazaa. That makes no sense, if I'm not the one who is using Kazaa at the time they how can they be sure it got to me at all? With all the people who have come and stayed in my apartment, sub-letters or roommates I've had it would be nearly impossible to monitor everything they have done or seen when they borrowed my computer for use. I wonder why the RIAA didn't send a letter in my name to my address to make me, personally, aware of their intentions. I would have ceased and desisted on the spot and I would have made sure other members of my household did the same. The RIAA never gave me that chance.

Unfortunately I was the person whose name was put on the cable bill when the household bills were divvied up amongst roommates and so I get to be held responsible for the several hundred songs listed on the summons while I am only personally responsible for one hundred and eight songs. Sixty-three songs of those one hundred and eight I already owned on CD and out of those sixty-three there were six which I downloaded and then went to the store and bought the artist's CD. I have been a music fan all my life and until recently had still bought CDs of the artists I love because I want to support them. I won't be buying any more and I know many other consumers feel the same.

The financial punishment and personal stress I've suffered seem a heavy price to pay to far what I've been accused of. I've settled my lawsuit, gained a whole education of what is really at stake here and my main concern now is that this stop happening to other people. It's not fair to others like me who weren't duly warned nor had any idea what others were doing on their computers. We need to change this system without creating any new victims. I hope that change starts here.

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Statement of
Jonathan D. Moreno, Ph.D.
Emily Davie and Joseph S. Kornfeld Professor
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University of Virginia
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Mr. Chairman, honorable members of this subcommittee:

On previous occasions I have testified before congress as a bioethicist; today I appear before you in my more general role as a social ethicist. Social ethics calls on diverse fields for guidance: the law, philosophy, religious traditions, history, and the social sciences.

In one sense the question before us is straightforward. To intentionally take that which does not belong to you is to violate the social contract. Intellectual property is a form of property, and intellectual theft is a form of theft. Under such circumstances the justifiable legal response is clear: Those who commit theft are liable to punishment.

Yet if our goal is not merely to be punitive, but to craft an effective public policy, the law is a notoriously blunt instrument. There are many social behaviors in which the rigid application of the law is not only ineffective in solving the essential problem, but may actually aggravate the problem by encouraging offenders to find ingenious new ways to evade authorities. Prosecution may also be disproportionate to the value lost, seemingly arbitrary in its selection of targets, and erroneous.

Further, if powerful and distant entities that control a highly valued item institute legal measures that are widely perceived as draconian, they may encourage disrespect for law, especially among the young. Still more complex are situations like this one, in which the culture itself is evolving in tandem with technological change.

The underlying problem is this: Many people with otherwise healthy moral intuitions fail to see internet file-sharing as theft, or if they do, they do not perceive it as wrong, or at least not *very* wrong. Of course the pricing structure of compact discs is widely resented because the blank CD is so inexpensive and downloading can be accomplished with ease. But these facts do not explain the largely guilt-free social psychology of so many file sharers. A more nuanced explanation is required.

First, those who are victimized are "moral strangers," are distant and unknown to us as individuals. Harms to moral strangers do not easily excite our guilt.

Second, consumers have become accustomed to the portability and transferability of music, partly because of successful marketing by the industry.

Third, unlike familiar forms of copying a recording, as in the case of "bootleg" audio tapes, the copy never needs to be a physical object but can remain in electronic form. Physical associations with theft may be absent.

Fourth, the very term file-*sharing* connotes altruism and community. In particular, many adolescents find a sense of community more easily in the World Wide Web than in the rest of their lives. In this case what seems to be an impersonal, wealthy and imperious industry places itself in opposition to this otherwise positive value.

These factors do not justify theft, but file-sharing is not simply an attack on the concept of private property. It is a demand for access to a highly valued social commodity, a demand triggered and facilitated by technology. A new interpretation of the social contract is emerging, and industry and the law must take note.

If file-sharing is the wave of the future, as many believe it is, then adversarial approaches should not be the first, and certainly not the only response. Though aggressive prosecution may result in a short-term deterrent, in the long run it cannot stem the cultural tide.

In the short run, the industry should expand its effort to acquaint us with its moral strangers, the hard working men and women behind the scenes. Taking a longer view, the music industry must adapt its business model to the new culture. It must explore measures to renew consumers' sense that they are being dealt with fairly. Devising alternative pricing structures through the Web, developing technologies that allow for appropriate personal use, and building more value into the product are among the constructive approaches that should be at least as aggressively pursued as legal remedies.

In their wisdom, the framers of the constitution specified that inventors should have rights over their products "for limited times." They were concerned to balance the right to property with the need for civil society to flourish through the vibrant exchange of ideas. Artistic media are especially important for social flourishing because they create the common coin of human experience. In this field, civil society itself is changing, and the music industry must change with it. Measures to protect the legitimate interests of artists and the industry should be as creatively and sensitively crafted as the artistry itself.

Thank you.

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September 26, 2003

Before the Permanent Subcommittee On Investigations
Committee On Governmental Affairs
United States Senate

STATEMENT ON
PRIVACY & PIRACY: THE PARADOX OF ILLEGAL FILE SHARING ON PEER-TO-PEER NETWORKS AND THE IMPACT OF TECHNOLOGY ON THE ENTERTAINMENT INDUSTRY

September 30, 2003

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My name is James V. DeLong. I am Senior Fellow and Director of the Center for the Study of Digital Property at The Progress & Freedom Foundation in Washington, D.C.

PFF is a market-oriented think tank that analyzes the digital revolution and its implications for public policy. For more information about us, a copy of our Mission Statement is attached to at the end of this Statement.

It is a pleasure to be here today to talk about intellectual property, Peer-to-Peer (P2P) file sharing, and private and public responses. The Digital Age has the potential to foster the creation of an immense quantity and variety of intellectual riches of all kinds – music, books, journals, software, movies, video. Whether this potential is fulfilled depends largely on whether appropriate property rights and markets are developed and enforced, so this issue meshes neatly with the issues of regulatory policy and the protection of markets that PFF has addressed during its decade of existence.

I will focus first on a question that receives too little attention, in my view. It is: What is the true interest of consumers in this controversy?

Much of what I read on the issue of intellectual property generally, including much that is written by "consumer representatives," treats the issue as a zero sum conflict between creators of intellectual property on the one hand and consumers on the other. Such work

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often talks about the need to "balance" the interests of the two groups. The underlying assumption seems to be that the consumer interest lies in getting creative work for free – indeed, it is often portrayed as virtually a *right* to get things for free -- and that society grudgingly chip away at this consumer interest so as to give producers some incentive to produce.

This view of the world is erroneous – as a matter of economics, morality, and law.

The true interest of consumers is in having a strong system of intellectual property rights and well-functioning markets that makes available a wide variety of products and that enables consumers to vote with their payments to influence what is produced. The only question worthy of consideration by Congress is what it can do to help us ensure that such a market system exists.

Let me use three thought experiments designed to illustrate the absurdity of the "information ought to be free" line of argument, and the reasons why it seems obvious that the true interest of consumers is in property rights and markets.

First, consider an information service here in Washington called *TechDaily*. I am sure most people at this hearing are familiar with it. It is an e-newsletter issued twice a day that covers developments in the tech world. It is comprehensive, well-written, thoughtful. It is accessed by password and it not cheap, in absolute terms, but my organization's site license is spread over several of us so my access to it costs a couple of bucks a day, which is a true bargain.

Now, suppose a "consumer representative" decides, after "balancing the consumers' interest" against that of the producer, that *TechDaily* charges too much. After all, the marginal cost of adding me, or any other individual, to the distribution list is zero. So every day this "consumer representative" cuts-and-pastes the newsletter and blasts it out to the world at large. Of course, *TechDaily* soon goes out of business. Or it is forced to revert to the pre-Internet mode of operation, in which it is printed up each night on flimsy pastel paper (to discourage photocopying) and hand-delivered in the wee hours of the morning, thus becoming both less timely and more expensive.

I am the consumer here. On what possible theory can the "consumer representative" who caused this carnage call himself my friend?

To extend this thought experiment further, suppose *TechDaily* wants to stop this practice. Should the "consumer representative" be able to claim that to allow the company to ascertain his identity is a violation of his right to privacy on the Internet? Suppose that such a privacy claim were upheld; the losers would include not just *TechDaily*, its investors, and employees, but me - the consumer -- and all my fellow consumers, who have been deprived of a valuable service for which we were paying a quite reasonable price.

To extend the analysis another step, consider the effect of this chain of events on the structure of this city. My organization is a small one. It, like other small organizations and individuals, cannot afford the legion of reporters needed to produce a work like *TechDaily*. Nor can it afford the price of a newsletter produced according to the old-fashioned print-and-hand-distribute methods. So one effect of eliminating e-distribution as an option would be to ensure that only large organizations, those which can spread overhead across a wide base, could survive. The creative impetus that can be provided by individuals and small businesses would be lost.

This example may seem extreme, because almost no one would admit openly to wanting to destroy the intellectual property rights that make *TechDaily* possible. But if you dissect the rhetoric of many of the consumer groups you will find that their proposals would have precisely this impact. For example, they would say that *TechDaily* should not be allowed to encrypt its product in a way that inhibits someone from making a backup copy, or from shifting the use in space or time, because these constitute "fair use." In effect, of course, destroying the ability to encrypt or to control access would have the effect of destroying the property right entirely, and the advocates of such positions are fully aware of this. Much advocacy of "fair use" is in fact a torpedo attack on the very concept of intellectual property rights.

Thought experiment number two concerns the common grocery store. Would anyone ever claim that consumers should get groceries for free, and that we must "balance the interests" of consumers against the interests of food producers and grudgingly allow producers to charge something (but not too much)?

We would regard such a statement as absurd on its face. The interest of consumers lies in being able to pay for things, so that producers are induced by their own interests to produce food. Then these producers become consumers of other goods and pay other producers who then become consumers, and so on in that great chain we call the free market.

The same logic applies to intellectual creations. The argument that these are somehow different and thus should be subject to different rules rests upon misinterpretations of economic principles concerning marginal cost pricing and upon such economic concepts as "non-rivalry" and "exhaustion."[1] These concepts are indeed important, but they do not undercut the elementary truth that products of the intellect, like physical goods, are best produced by market incentives, and that propositions that are absurd on their face when applied to groceries do not become sensible when applied to the world of creativity.

Thought experiment number three is based on my personal experience walking through book stores. I see many a work that I might like to read, or perhaps read part of to see if I want to read it all, that I pass by because I will not lay out the $25 to $40 price. Suppose a system existed whereby I could tailor my investment. For a dollar, I could access it for a day to decide if I am seriously interested. For $4 or $5, I could read it once. For $30, I

[1] James V. DeLong, "Marginalized," *TechCentralStation*, July 29, 2003 <http://www.techcentralstation.com/072903D.html.>.

could add it to my permanent library. Clearly, I as a consumer would be better off to have all of these options available.

Yet, again, self-styled "consumer representatives" want to deny me this choice. They raise the horrible possibility that the book industry might impose "pay per use," whereby the level of payment would be tied to the intensity of the use made of the work. Why, where would this end? Next thing you know, people will be renting videos rather than being forced to buy them; perhaps grocery stores would even start charging more for a gallon of ice cream than for a quart!

As in the case of *TechDaily*, or the grocery store, how can people call themselves my friends when they want to deny me options that, in my judgment, make me better off?

The logic of these three thought experiments applies to the music business, the entertainment business, or any other product. Obviously, any individual consumer would be best off if everyone else paid for things while he or she got things for free. Equally obviously, the economy and the social system do not work this way, and only very small children and psychopaths think it should. The rest of us know that societies and economies are built on reciprocity. You produce something, I produce something, and we trade. Or, in anything beyond a barter economy, we both trade with a number of third parties using money and the market as the intermediary mechanism for achieving this state of reciprocity.

The Internet is a wonderful invention for the distribution of intellectual creations because it vastly reduces the transaction costs, thus allowing these reciprocal arrangements to take place with minimum friction. One sends bits over fiberoptic cable instead of putting them on pieces of plastic and shipping them by truck.

The Internet also expands the potential dimensions of markets to include the whole world, which will greatly increase the variety of creations available. Those who say that music can be free while bands make money from concerts miss a crucial point. If a band can sell its music over the Internet, all it needs to support itself is enough paying fans scattered all over the world. If it can exist only through concert sales, then it must have a critical mass in every city. So only the most popular acts would be able to exist at all, and the people in small areas lacking a critical mass would get no music.

Unfortunately, getting to this happy state of Internet markets is not easy. The outlines of what is needed are clear, though, even if the exact path is not, and a workable long-term system for music will include:

Legitimate Downloading Services

Clearly, music and other intellectual products must be available on a paying basis through legitimate channels. The music industry knows this as well as anyone, and is working to make it happen. But this is not easy. Music copyrights are a tangled mess, and it very difficult to negotiate out all the interests involved. In addition, the

existence of the unauthorized downloading services substantially discourages investment in legitimate channels.

As a matter of ethics, an individual consumer could take the view that it is up to the industry to figure out how to make music available online and that the consumer will be happy to pay when this is achieved, but that he is not willing to pay to put bits on plastic and move them around the country by truck when this has ceased to be necessary. But as the online services are indeed coming into existence, this rationale is losing force.

Digital Rights Management

Legitimate channels must have a way of collecting money, which means that the product must be controlled by some method of electronic locks and keys. Furthermore, consumers will be better off if they are presented with options containing different packages of rights offered at different prices. Such packages require DRM. It is very important that DRM not be undermined by abstractions about "fair use." If DRM allows producers of IP to tailor their offerings to the desires of consumers, we will all be better off. Let a hundred business models bloom.

Education

The affected industries are sponsoring education programs on why unauthorized downloading is wrong. Education should go further: it should also emphasize fundamental explanations why property rights and markets are important, and why we are all better off if they are enforced and observed. In the end, as noted above, each individual would be better off if he got to cheat while others played by the rules, but this is not the way societies work. The downloading issue presents a Prisoner's Dilemma problem, and as author William Poundstone noted, "Study of the prisoner's dilemma has great power for explaining why animal and human societies are organized as they are. It is one of the great ideas of the twentieth century, simple enough for anyone to grasp and of fundamental importance."[2] The consumer who downloads music through unauthorized channels is cheating his or her fellow consumers because the practice involves free riding on their payments. Of course, if everyone tries to free ride on everyone, the system does not work at all.

Enforcement

It is not possible to do without enforcement efforts. No matter how well-protected by DRM, intellectual products such as music must be channeled through an output device, and they can be captured, redigitized, and sent out over the Internet. The problem can never be eliminated, but, hopefully, as legitimate services become plentiful, enforcement can be relegated to the minor role in the system that it plays in other areas, such as the protections against shoplifting in the retail system.

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[2] William Poundstone, *Prisoner's Dilemma*. Doubleday Anchor: 1992, p. 9.

> No one likes the current enforcement offensive, least of all, I suspect, the RIAA, but there is a serious chicken and egg problem. Why should anyone invest in legitimate services if they will be forced to compete with free, which is the road to bankruptcy? On the other hand, unless legitimate services exist, consumers will feel justified in using the unauthorized ones. In my view, one strong reason for the RIAA to launch its current enforcement effort was to signal potential investors that the industry is serious about supporting efforts to create legitimate channels. This will help us get through the awkward chicken-and-egg problem as quickly as possible.
>
> **Benign Neglect by Congress**
>
> This body is under continuing pressure to enact temporary fixes in response to the perceived crises of the day. It should resist. Most of the proposals are bad ideas that will inhibit the creativity of the market system and damage everyone. They are backed by slogans rather than analysis. Such proposals also compound the aura of uncertainty that surrounds the area, and thus inhibit the investment and effort needed to establish legitimate channels and get the whole problem behind us.

I am an optimist. The problems can be solved, and we can indeed reach the promised land of a vibrant system of intellectual creativity sparked by property rights and the market. But it will take steadiness on the part of the Congress, and a willingness to support the fundamental values involved.[3]

Finally, while most of this statement has concerned the interests of consumers, some very fundamental rights of creators are at stake as well. In 1972, the Supreme Court was confronted with an argument that "mere" property rights should be treated as unworthy of Constitutional protection. It responded:

> [T]he dichotomy between personal liberties and property rights is a false one. Property does not have rights. People have rights. The right to enjoy property without unlawful deprivation, no less than the right to speak or the right to travel, is in truth a "personal" right, whether the "property" in question be a welfare check, a home, or a savings account. In fact, a fundamental interdependence exists between the personal right to liberty and the personal right in property. Neither could have meaning without the other.[4]

Intellectual property is encompassed by the Constitutional protections of property, and by these principles.[5] And as a higher proportion of society's collective effort is devoted to the production of information goods rather than physical goods, the need to defend the rights of creators, and their support network of employers and financiers, grows apace.

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[3] For further discussion of many of these issues, see James V. DeLong, *Intellectual Property in the Internet Age: The Meaning of Eldred*, Progress & Freedom Foundation Progress on Point No. 10.5 (Feb. 2003) <http://www.pff.org/publications/POP10.5.pdf>.

[4] Lynch v. Household Finance Corp., 405 U. S. 538, 552 (1972).

[5] *E.g.*, Ruckelshaus v. Monsanto Co., 467 U.S. 986 (1984).

In closing, it is worth emphasizing that there is no conflict between the rights and interests of producers of intellectual property and the interest of consumers. As Justice Ginsburg said in her majority opinion in the recent Supreme Court decision *Eldred v. Ashcroft*:[6]

> As we have explained, "the economic philosophy behind the [Copyright] Clause . . . is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors." *Mazer* v. *Stein*, 347 U.S. 201, 219, 98 L. Ed. 630, 74 S. Ct. 460, 1954 Dec. Comm'r Pat. 308 (1954). Accordingly, "copyright law *celebrates* the profit motive, recognizing that the incentive to profit from the exploitation of copyrights will redound to the public benefit by resulting in the proliferation of knowledge . . . . The profit motive is the engine that ensures the progress of science." *American Geophysical Union* v. *Texaco Inc.*, 802 F. Supp. 1, 27 (SDNY 1992), aff'd, 60 F.3d 913 (CA2 1994). Rewarding authors for their creative labor and "promoting . . . Progress" are thus complementary; as James Madison observed, in copyright "the public good fully coincides . . . with the claims of individuals." The Federalist No. 43, p. 272 (C. Rossiter ed. 1961). JUSTICE BREYER's assertion that "copyright statutes must serve public, not private, ends" *post*, at 6, similarly misses the mark. The two ends are not mutually exclusive; copyright law serves public ends by providing individuals with an incentive to pursue private ones.

[6] Eldred v. Ashcroft, 537 U.S. 186, ___ n. 18 (2003).

THE PROGRESS & FREEDOM FOUNDATION

MISSION STATEMENT

The Progress & Freedom Foundation is a market-oriented think tank that studies the digital revolution and its implications for public policy. Its mission is to educate policymakers, opinion leaders and the public about issues associated with technological change, based on a philosophy of limited government, free markets and individual sovereignty.

PFF's research combines academic analysis with a practical understanding of how public policy is actually made. Its senior fellows and other scholars are leading experts in their fields, with distinguished careers in government, business, academia and public policy. Its research is substantive, scholarly and unbiased. At the same time, PFF is focused on having an impact on public policy.

PFF's underlying philosophy combines an appreciation for the positive impacts of technology with a classically conservative view of the proper role of government. We believe that the technological change embodied in the digital revolution has created tremendous opportunities for enhanced individual liberty, as well as wealth creation and higher living standards. Those opportunities can only be realized if governments resist the temptation to regulate, tax, and control. Government has important roles to play in society, including protecting property rights and individual liberties, but its tendency is to reach beyond its legitimate functions in ways that harm consumers, burden citizens and slow progress.

PFF is an effective voice for market-oriented policy in a variety of key issue areas. Among its contributions:

- Leading the intellectual battle for true deregulation of communications markets, including immediate deregulation of broadband services, and forbearance from regulation of wireless communications and the Internet.

- Explaining the imperative to protect rich digital content and encourage innovation through the traditional legal notions of copyright and patent.

- Urging private solutions to help reduce digital piracy and increase the availability of rich digital content, without government mandates.

- Explaining the need for lower taxes on telecommunications services, a tax moratorium for Internet commerce, and privatization of government-run cable TV and telephone companies.

- Promoting competition in electricity markets, using demand-side, deregulatory market mechanisms rather than pervasive and costly government regulatory schemes.

- Advocating antitrust over regulation in the software market.

- Applying benefit-cost analysis to proposals for regulation of the market for personal information, and showing why severe regulations will not protect online privacy.

For ten years, from the beginning of the Internet Revolution in 1993, through the high-tech meltdown of 2000-2002 and beyond, PFF has been a consistent voice for a market-oriented approach to capturing the opportunities presented by technological progress.

Located in Washington, DC, The Progress & Freedom Foundation is a 501(c)(3) nonprofit organization founded in 1993.

hoodlums™
new & used music & dvds

September 28, 2003

Honorable Norm Coleman
Chairman
Permanent Subcommittee on Investigations
Senate Governmental Affairs Committee
199 Russell Senate Office Building
Washington, DC 20510

Attention: Ray Shepherd, Staff Director

Dear Senator,

My name is Steve Wiley. My partner, Kristian Luce, and I own an independent CD/DVD store in Tempe, Arizona. *Hoodlums New and Used Music* is located in the Student Union at Arizona State University, home to 57,000 students and an area that many would consider the epicenter of the digital music debate. Consequently, we were asked by the *Coalition of Independent Music Stores (CIMS)* to weigh in on the issue of downloading and file-sharing.

We sell music to file-sharers everyday, and we are here to present a different view to the committee.

We are ultimately qualified to speak on this subject. Our store opened in 1998, during the peak of Napster. Six years later, in spite of a more than ten-fold increase in file-sharing, we are having our best semester ever. September will be the biggest month in our history. Over the past two years, we have seen more than 1,250 kids fill our frequent-buyer card, which requires the purchase of twenty CDs or DVDs. When surveyed, over 95% of these music-buying customers told us that they also downloaded free music over the Internet.

We have extensive conversations with our customers (nearly all of whom engage in the practices currently being litigated by the RIAA) regarding the topic of file-sharing on a daily basis. We constantly ask them their views on each new digital development. We make it a practice to never judge or argue with our customers, regardless of their stance on the issue, trying instead to empathize with them (it is pretty easy to do since we are music fans too). Consequently, they feel comfortable to give us no-holds-barred feedback. We use that feedback to tailor our store to *their* needs.

While we are against the idea of people not paying for music, we are totally opposed to the notion that file-sharing is the primary cause of the woes facing the music industry. More often, we feel that it is more of a convenient scapegoat for out-of-touch label executives and record store owners, many of whom thrived in the "replace-your-LP-with-a-CD" era but are having trouble today because they are continually trying to fit a new breed of customers and technology into the old model of doing business... instead of adapting to the customer's needs.

Based on our observations and conversations; we would like to offer up the following opinions:

1. High prices are by far a bigger contributor to the drop in CD sales than file-sharing. For that matter, price is the single biggest factor in driving kids to illegally file-share in the first place. The major labels are simply asking too much money for their product. The kids are still as hungry as ever for music; they just can't afford to pay the inflated prices (which, in the face of all economic logic, have gone up as sales have decreased). As a result, most of them feel that they are justified in going on the Internet and satisfying their musical needs… or they find more affordable entertainment product, like DVDs, to purchase.

2. There still isn't a viable option to pay for digital music. In spite of the fact that millions of potential customers are going to the Internet to find new music – the industry has still not given them a truly viable way to pay for it. While a few high-profile online stores have recently gained press and popularity, the public is telling us that ninety-nine cents per song is still too expensive to deter them from going to their favorite file-sharing site and getting it for free. They also hate being restricted as to how many times they can move the music between CDs, computers, and their portable devices - a stipulation we believe is currently demanded by the majors on all legitimate Internet services.

3. The Internet helps as much as it hurts. It's hard to quantify; but while common sense tells us that some record sales have been lost to free file-sharing; we believe that the Internet has promoted more than an equal amount of sales by providing kids the last true route in which to discover new music.

Since the *Federal Telecommunications Act of 1996*, TV and radio stations have been swallowed up by corporate behemoths like Clear Channel (over 1,200 U.S. radio stations) - resulting in smaller play lists and less diversity nationwide. Without the Internet to pick up the slack, we feel that demand for music would have suffered and many more customers would have turned to DVD, video games, and other forms of electronic entertainment.

A huge amount of Hoodlums' current CD sales are a result of a demand for music created solely by the Internet. Our customers can't afford to pay fifteen to twenty dollars to experiment, so they go online and download music to test it out. Once they are sure they like the artist, they will come in and buy the CD (assuming the price is right).

4. Suing the end-user is a public relations nightmare that will not ultimately solve the file-sharing problem. These kids think that the RIAA and the major record labels are the enemy. This can not be understated. Not only have the RIAA's recent attacks not deterred them from file-sharing; they have seemingly made them more defiant about the issue. While most of them are smart enough to know they are breaking copyright laws – we rarely talk to a customer that truly has moral misgivings about downloading or file-sharing. It may sound harsh, but judging from what we see every day… trying to win this battle on a moral level is a joke.

When we ask them if they are worried about getting sued – they respond with one of three general answers: a) "There's plenty of websites and P2P services that protect my IP address"; b) "They can't sue everyone"; or most importantly c) "If the record companies don't like it, they should lower prices".

How have we managed to survive, sometimes even thrive, with these realities? Better yet, do we have any solutions? It's a complex issue – but here are a couple of ideas:

Solution 1: Lower prices. Most customers *do* want to support the artist. They *will* pay for music at a fair price. Our experience indicates that a fair price is $13.99 or below (five dollars below the major label's current primary list price). By focusing on less expensive new music (featured by many independent artists and labels), and used CDs (which are under ten dollars each), Hoodlums is currently selling music to file-sharers all day long.

Solution 2: Create a subscription based Internet service similar to cable TV. For a flat and reasonable monthly fee, allow customers to download as much music as they want and allow them to transfer their digital music to as many digital devices as they want. For ten or fifteen bucks a month… the demand would be staggering.

Look at the current percentage of the U.S. homes that currently have cable TV – if even a small percentage of that total signed up for a similar music service – the resulting subscription revenue would quickly eclipse current yearly revenues of online and CD sales combined.

The artists would be able to collect royalties based on the amount their music is downloaded or sampled, allowing them get paid in an area for which they currently receive nothing. This service would also allow the labels to enjoy an entirely new revenue stream, which would help them lower the prices of their physical goods, which, as we said, is the ultimate key to the issue.

Do we worry that such a service would put record stores out of business? Hardly. We think it would increase sales by raising demand and lowering prices. Let's face it, the customer can get it for FREE on the Internet already and many are still buying CDs. When America got hip to cable TV; the networks survived. With the advent of the VCR; movie theatres survived. Likewise with a service like this; while the customer's habits would change (and let's face it – they are changing anyway), the good record stores would survive.

Solution 3: Stop prosecuting kids. Basically, it would be nice to see the major record labels and the politicians quit trying to prosecute our customers….and start figuring out a way to give them what they want. We truly believe that due to their limitless knowledge of computer technology, file-sharing on the Internet will never truly be stopped. Why not find a way to harness its power rather than continuing to focus on ultimately futile efforts to contain it.

These kids currently view our entire industry as an evil entity. Considering they are our future - and we are peddling one of the most desirable products in the world – it shouldn't be that way.

We appreciate the opportunity to allow us to voice our opinions on this matter. While we realize they may fly in the face of the testimony of many – we think they are very realistic.

Feel free to contact Kristian or Steve at 480-727-8733 with any questions or comments.

Sincerely,

Steve Wiley
President
Hoodlums New and Used Music

RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
SUBMITTED BY
SENATOR NORM COLEMAN
Chairman, Permanent Subcommittee on Investigations
for
MITCH BAINWOL
Chairman & CEO
Recording Industry Association of America (RIAA)

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
PRIVACY & PIRACY: THE PARADOX OF ILLEGAL FILE SHARING ON PEER-TO-PEER NETWORKS AND THE IMPACT OF TECHNOLOGY ON THE ENTERTAINMENT INDUSTRY
SEPTEMBER 30, 2003

Has Sharman Networks made any changes to KaZaA that make it more difficult for you to identify the most frequent copyright abusers and to inform them that their actions are illegal?

Yes. Sharman Networks has changed KaZaA's default settings in its most recent version (version 2.5.2) in two very important ways that hamper RIAA's ability (1) to identify those engaging in substantial amounts of illegal activity and (2) to notify infringers that their activity is illegal.

First, as you are aware, RIAA at this time is focusing its enforcement efforts on egregious infringers, those who are engaging in substantial amounts of illegal activity. To identify individual users of KaZaA who are making substantial amounts of copyrighted material available for copying, RIAA uses software that logs onto KaZaA's open network – just like any other user – and searches for recordings owned by RIAA's members. Prior to version 2.5.2, such a search generally would reveal all of the copyrighted music files that a particular user was offering illegally to distribute. In version 2.5.2, Sharman has switched the default settings so that such a user does not automatically reveal all of the music files he or she is making available for copying. Thi change by Sharman hinders the ability of copyright holders to identify egregious infringers without changing any of the underlying defaults that make files available for distribution. It thus will impair copyright holders' ability to exercise proportionality as t whom they will pursue, and may result in pursuit of users who are making only small quantities of copyrighted material available; but, the change does not at all alter the amount of copyrighted works that are being distributed on the network by the users.

Second, since April 2003, RIAA has been sending Instant Messages – and has now sent well over 4 million – directly to infringers on peer-to-peer networks. These messages inform infringers that their actions are illegal and direct them to the Music United website (www.musicunited.org) for information on how they can avoid breaking the law. In version 2.5.2, Sharman, far from cooperating with this attempt to educate its

users about the law, reconfigured its software to disable the instant messaging system, thereby preventing RIAA from sending messages to KaZaA's newest users. At bottom, this change takes away from copyright holder the ability to urge individuals to stop infringing without having to resort to litigation.

Finally, it should be noted that Sharman's ability to make these changes reveals the closed, proprietary nature of the KaZaA system. It shows not only the control that Sharman has over how its system operates, but also how Sharman contributes to, encourages, and protects from scrutiny the illegal conduct that it knows is occurring on its system. In addition to these most recent changes, Sharman continues to establish default settings that, unless affirmatively changed by the user, automatically make the files on the user's hard drive available for copying by anyone else on the network.

Mr. Morris of Sharman Networks has asserted that peer-to-peer file sharing has actuall increased legitimate sales of music CDs. What evidence supports your claim that the opposite is true?

The amount of music piracy on the Internet is astounding. Computer users illegally download well over a billion copyrighted files (mostly recordings) every mont At any given moment, well over five million users are online offering well over 1 billio files for copying through various peer-to-peer networks. If this rampant illegal activity were actually increasing legitimate sales, then legitimate sales should be increasing substantially. Instead, the opposite is occurring. In the past three years, shipments of recorded music in the United States have fallen by 26 percent, from 1.16 billion units in 1999 to 860 million units in 2002. The harmful effect of illegal copying on legal sales i dramatically illustrated by its effect on new releases of popular songs. Today, there is a huge decline in sales between the first and second week of such songs. Ten years ago – prior to the ready availability of free, illegal copies of virtually identical sound quality – there was no such decline. [More detail re these facts?] It thus simply defies logic and reason to conclude that illegal copying is increasing legal sales.

Moreover, peer-to-peer users themselves confirm that their illegal copying cause them to purchase less music. According to a November 2002 survey by Peter D. Hart Research, by a nearly 2-to-1 margin, consumers who say they are illegally downloading more music report that they are purchasing less. The same survey found that the main reason consumers are not buying more music is that they get a lot of what they want for free by illegally downloading or copying it from others. In a similar study conducted in May 2002 by Peter D. Hart Research, among 12- to 18-year-olds, 35 percent say the firs thing they will do after hearing a new song they like is download it, versus just 10 percent who will buy it. Among 19- to 24-year-olds, 32 percent download the new son first, versus 9 percent who will buy it. These findings are bolstered by a June 2003 Edison Media Research report which found that "among the heaviest downloaders, 48%

say they no longer have to buy CDs because they could download music for free over the Internet" – an increase of 61 percent in just one year.

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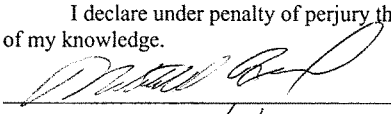
I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.



Dated: 11/10/03

RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
SUBMITTED BY
SENATOR CARL LEVIN
Ranking Minority Member, Permanent Subcommittee on Investigations
for
MITCH BAINWOL
Chairman & CEO
Recording Industry Association of America (RIAA)

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
PRIVACY & PIRACY: THE PARADOX OF ILLEGAL FILE SHARING ON PEER-TO-PEER NETWORKS AND THE IMPACT OF TECHNOLOGY ON THE ENTERTAINMENT INDUSTRY
SEPTEMBER 30, 2003

1. *Would the RIAA support a requirement that people whose personal information was being sought with a DMCA subpoena be notified and given a reasonable period to respond to the subpoena prior to having their personal information turned over by their service provider?*

As a general proposition, RIAA believes that notification to individuals whose identity is being sought with a DMCA subpoena is useful, and RIAA has encouraged Internet service providers ("ISPs") to notify their subscribers prior to revealing their identity to RIAA. To facilitate such notification, before filing a request for a subpoena, RIAA sends the infringer's ISP advance notice that RIAA intends to issue a subpoena with respect to a particular IP address. Among other things, that allows the ISP, if it wishes, to notify its subscriber that its account is soon to be the subject of a subpoena request. RIAA also has allowed subscribers to intervene in subpoena enforcement proceedings to assert any claims they may have that their identity should not be revealed. Furthermore, even after receiving a subscriber's identity, RIAA now is notifying the subscriber before filing a copyright infringement action against him or her.

That said, any legal requirement of notification would have to take into account the exigencies created by the immediate and viral nature of online illegal copying. An individual Internet pirate can cause tens of thousands of infringing copies to be distributed in a single day. By way of example only, in the case of a recording that has not yet been released publicly, the illegal distribution of just that one file can have a devastating impact on the sales of the forthcoming album. In the DMCA, Congress recognized the need for expedition, and it created a framework by which copyright owners, with the assistance of ISPs, could expeditiously identify individuals engaging in infringing activities online. As noted by Judge Bates – the federal district judge who presided over the subpoena enforcement proceedings between RIAA and Verizon – Congress provided "express and repeated direction to make the subpoena process 'expeditious.'" Judge Bates also recognized however that, at the same time, Congress provided "protections [that] ensure that a service provider will not be forced to disclose its customer's identifying information without a reasonable showing that there has been

copyright infringement" and "[t]hese requirements provide substantial protection to service providers and their customers against overly aggressive copyright owners and unwarranted subpoenas." Any effort to engraft onto those streamlined and balanced subpoena procedures a "reasonable period" for subscribers to respond would have to take into account that the amount of time that is "reasonable" would vary based on the particular circumstances of the illegal conduct at issue. Otherwise, one of the central purposes of the DMCA subpoena provision – expeditious relief for copyright holders – would be undermined.

2. *Do RIAA members who make "writable disks" include at the beginning of each disk a warning against using the disk to make unauthorized copies of copyrighted material?*

To my knowledge, no members of RIAA make "writable disks" onto which music files can be copied. To the extent that such disks are made or sold by corporate entities that are related to, but separate corporate entities from, members of RIAA, RIAA does not represent them and cannot speak with respect to their practices.

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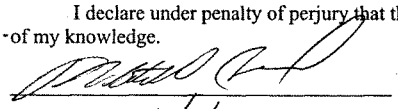
I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.



Dated: 11/19/07

RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
SUBMITTED BY
SENATOR TOM CARPER
for
MITCH BAINWOL
Chairman & CEO
Recording Industry Association of America (RIAA)

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
PRIVACY & PIRACY: THE PARADOX OF ILLEGAL FILE SHARING ON PEER-TO-PEER NETWORKS AND THE IMPACT OF TECHNOLOGY ON THE ENTERTAINMENT INDUSTRY
SEPTEMBER 30, 2003

1. *The RIAA contends that the 261 people it took to court for illegally downloading copyrighted songs were among the worst offenders. It is my understanding that many of them had downloaded thousands of songs. What were these people doing with the material they downloaded? Do you know if they were aware that what they were downloading was available for other Internet users to download from their computers? Were any of them attempting to earn money from the songs they downloaded?*

As you note, RIAA to date has brought copyright infringement suits only against the most egregious infringers, suing them both for illegally uploading and downloading copyrighted recordings. It is important to note, however, that RIAA has filed these suits based on the substantial amount of recordings these individuals were *uploading – i.e.,* illegally making available for others to download copies. Therefore, although we do not know everything that these users were doing with the recordings they downloaded, we do know that they were making them available to others to illegally copy.

As for whether those sued were aware that their files were available for copying by others, though not a requirement under the law to prove infringement, it is difficult to see how they would not have been. Beginning in April 2003, RIAA sent Instant Messages to every one of the KaZaA and Grokster users who was ultimately sued informing them that their files were available for copying and requesting them to cease and desist their illegal conduct. In addition, these Instant Messages were part of a much broader educational campaign by the music industry which has, for a number of years, undertaken to educate consumers regarding the illegality of the unauthorized distribution of copyrighted music online. The message of this campaign has been very clear: copying or distributing copyrighted music over the Internet without permission is stealing, plain and simple. Downloading illegal copies is no different than shoplifting CDs out of a record store, and uploading those recordings for others to illegally copy is no different than handing out stolen CDs on the street corner – and the act of downloading or uploading music on peer-to-peer networks is not an anonymous one. This message has been conveyed to the public in print and broadcast ads featuring more than a hundred major artists and songwriters who ask their fans to stop stealing their music. These ads have appeared in a wide variety of outlets, including USA Today,

BET, and MTV. Moreover, prior to beginning our efforts to collect information on substantial infringers, RIAA publicly announced its intent to do so, giving infringers another opportunity to discontinue their illegal conduct. Since that announcement, virtually every major newspaper and television news channel, and hundreds of local news outlets, have covered RIAA's heightened enforcement efforts.

Finally, though individuals generally do not make money from distributing works on peer-to-peer networks, we do not know whether any of the 261 infringers that RIAA sued was earning money from their infringing activity. Regardless of whether they were earning money from their activity, RIAA does know that their activity was illegal, that they were infringing on the property rights of those who owned the copyrights to the recordings, and (as described more fully below in response to your third supplemental question) that their illegal activity caused economic harm to the copyright holders.

2. *Do you have a problem with an Internet user downloading a copyrighted song for their personal use? How much freedom should music fans, whether they obtain their music in a store or online, have to make copies of songs or albums for their own use?*

Once an individual legally has purchased a sound recording (whether in a store or online), RIAA does not object to the purchaser making a copy for his or her own personal use. However, RIAA does object to the purchaser making unauthorized copies for others, and such copying is illegal. Such copying results in distribution of a work from one consumer to another potential consumer and thus also directly substitutes for sales by copyright holders.

Downloading a copy of a recording for one's own personal use from the Internet is no different in effect than shoplifting the recording for one's own personal use from a brick-and-mortar store. The online theft of the recording causes economic harm to the copyright holder by substituting for a legal sale that otherwise would have occurred.

3. *The decline in album sales in recent years has been dramatic. How much of it can you definitively say was caused by illegal file sharing? How much of it was caused by other factors, such as CD prices or economic recession?*

The decline in recent years in the sales of music recordings has indeed been dramatic, and the economic harm to copyright holders has been substantial. RIAA believes that the root cause for this drastic decline in record sales is the astronomical rate of music piracy on the Internet. Computer users illegally download more than a billion copyrighted files (mostly recordings) every month. At any given moment, well over five million users are online offering well over 1 billion files for copying through various peer-to-peer networks. As this illegal copying has become rampant, sales of music recordings has drastically declined. In the past three years, shipments of recorded music in the United States have fallen by an astounding 26 percent, from 1.16 billion units in 1999 to 860 million units in 2002. That this decline is caused by online illegally copying is confirmed by those engaging in the illegal conduct. According to a November 2002 survey by Peter D. Hart Research, by a nearly 2-to-1 margin, consumers who say they are

illegally downloading more music report that they are purchasing less. The same survey found that the main reason consumers are not buying more music is that they get a lot of what they want for free by illegally downloading or copying it from others. In a similar study conducted in May 2002 by Peter D. Hart Research, among 12- to 18-year-olds, 35 percent say the first thing they will do after hearing a new song they like is download it, versus just 10 percent who will buy it. Among 19- to 24-year-olds, 32 percent download the new song first, versus 9 percent who will buy it. These findings are bolstered by a June 2003 Edison Media Research report which found that "among the heaviest downloaders, 48% say they no longer have to buy CDs because they could download music for free over the Internet" – an increase of 61 percent in just one year.

Certainly other factors may contribute to the decline in sales. But it is worth noting that the music industry generally has not experienced a decline in sales in other periods of economic recession. And, in the last 20 years, the price of CDs in real dollars has decreased, not increased. For example, between 1983 and 1997, CD prices dropped 39% (compared to an overall rise in the CPI of 61%). Moreover, this price decline took place at the same time as the amount of music on a CD increased substantially. Measured by minutes of music on a CD, the price of CDs dropped 72% during this period. So it is equally difficult to see how the price of CDs could be the cause of the sales decline.

4. *What efforts have your members made to take advantage of the marketing opportunities peer-to-peer technology offers?*

Generally speaking, there are two sources from which consumers can get music online: (1) unlicensed peer-to-peer networks, and (2) fully licensed commercial entities, such as those described below. Given the overwhelming pirate nature of the peer to peer networks, record companies have focused on the opportunities available from fully licensed commercial ventures which provide a business model that will compensate artists and others who own rights in the music. In so doing, the music industry has responded to consumer demand by making its music available to a wide range of authorized online subscription, streaming, and download services that make it easier than ever for fans to get music legally on the Internet. Recently, Apple iTunes launched a version of its service for the PC, and Apple reported sales of over a million tracks within four days of launching iTunes. In the United States market alone, there are dozens of excellent legitimate online services that offer a variety of choices legal and inexpensive ways to enjoy and purchase online music. Other recent launches include MusicMatch and Napster 2.0. Additional services include:

aolmusic.com, audiocandy.com, bestbuy.com, bet.com, buymusic.com, catsmusic.com, CircuitCity.com, collegeconcerts.com, cornercd.com, dimple.com, dothehole.com, earwax.com, emusic.com, exitosmusical.com, fullaudio.com, FYE.com, galleryofsound.com, independentrecord.com, instavid.com, latinoise.com, liquid.com, burnitfirst.com, listen.com, mainstreetmusic.com, millenniummusic.com, miramag.com, mp3.com, mtv.com, musicmatch.com, musicmillennium.com, musicnet.com, musicrebellion.com, netscape.com/music, newworldrecord.com, phillysoulclassics.com,

qhut.com, rasputinmusic.com, real.com/realone/rhapsody, recordandtapetraders.com, rollingstone.com, samgoody.com, spinner.com, streamwaves.com, tophitsmusic.com, towerrecords.com, windowsmedia.com.

RIAA fully supports these legitimate services, which amply demonstrate that music lovers need not break the law to obtain their favorite music online.

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I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Dated: 11/14/07

RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
SUBMITTED TO
JACK VALENTI
President & CEO
Motion Picture Association (MPA)

QUESTIONS SUBMITTED BY SENATOR TOM CARPER:

1. **While it is unclear how much of a factor illegal file sharing has been in the recording industry's recent decline, it has certainly played a major role. What impact has the illegal downloading of films had on box office receipts? What impact has it had on DVD sales?**

   We believe that Internet piracy has an effect on foreign box-office receipts and a significant impact on DVD and home video sales. "The Hulk" is a prime example of how Internet piracy significantly impacts box office receipts, both domestically and internationally: This film was illegally distributed on the Internet before its theatrical release and while it was still in an incomplete format; Universal Studios estimates they lost ten of millions of dollars in sales as a direct result. Moreover, when a film in domestic theatrical release is available on the Internet in a foreign country before it is released there, we believe it diminishes the actual sales in that country. Right now, the following movies, which are still in theaters, can be found on peer-to-peer networks: "Out of Time," "Mystic River," "Good Boy," "Radio," "The Matrix: Revolutions," "Scary Movie 3," and "Kill Bill."

   While the DVD sales continue to grow, DVD sales *per person* have actually declined over the past two years. One would expect a slowing as the product matures; however, we believe that the per person decline can be partly attributed to Internet piracy.

2. **What efforts have your members made to take advantage of the marketing opportunities peer-to-peer technology offers?**

   MPAA member companies are poised to embrace the digital future via legal Internet distribution companies such as Movielink and CinemaNow. Both companies allow movies to be downloaded via the Internet for a reasonable price. Movielink, for example, works by allowing each downloaded film to remain usable for up to 30 days and customers have 24 hours to watch a movie once they begin playing it. CinemaNow already has more than one million users per month, and has over 3,000 feature length films available via the Internet and private broadband networks. Our member companies are also offering customers the option of digital cable VOD through such services as iN DEMAND, HBO on Demand, Showtime on Demand, Cinemax on Demand, Time Warner Cable: Movies on Demand with iControl; Comcast Digital Cable on Demand, Charter Communications VOD, and Cablevision iO (Interactive Optimum) VOD, which includes Disney Channel and Fox on Demand. HBO on Demand, for example, is a subscription service that allows its customers to watch unlimited HBO shows at whatever time they want, while also having the VCR-like functionality to pause, fast forward and rewind.

   Individual MPAA member companies do not have business relationships with peer-to-peer sites such as Morpheus, Grokster, KaZaa, or Lime Wire because those companies have no acceptable mechanism for compensating copyright holders for their works. The lack of control endemic to peer-to-peer networks also leads to an environment rife at all levels with lurid pornographic content. Our companies under no circumstances want their works being distributed in a setting where innocent searches, such as for "Harry Potter," come back with pornographic content. Moreover, it is hard to work out a business arrangement with a P2P company whose business model is based on unauthorized and uncompensated distribution of intellectual property.

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RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
SUBMITTED TO
ALAN MORRIS
Executive Vice President
Sharman Networks Limited
(Parent Company of KaZaA)

QUESTIONS SUBMITTED BY SENATOR NORM COLEMAN
Chairman, Permanent Subcommittee on Investigations:

1. **What percentage of users have downloaded the most current version of Kazaa? How many individuals still are using earlier versions?**

   The answer below is largely identical to one provided in response to questions posed by Subcommittee Staff in July 2003. Since that date, a revised version of the software, version 2.5.2, has been released, but does not contain significant changes.

   Of the 291,366,082 instances of Kazaa Media Desktop download (sourced though Download.com), Sharman Networks Limited has no way of measuring the percentage of users who are using the most current version of the application. There is equally no way of knowing the number of users that are using earlier versions, or which earlier versions they are using.

   The most recent significantly upgraded version of Kazaa Media Desktop (v2.5.1) was made available on the 15th July 2003. Version 2.5.1 has P2P powered virus protection which is now enabled by default and provided for free to users; additionally, the adult content filter has been updated and is set in the 'on' position by default during installation. The installation process is simpler and makes it easier and clearer for users to understand exactly how the application works.[1]

   Sharman Networks actively encourages users to upgrade to benefit from such changes when new versions are available through pop-up windows and announcements both from the web site (kazaa.com) and the application itself.

   Unfortunately there is no way to determine exactly how many people have upgraded to the latest version, but partner statistics indicate that over 25% of actual installations each week are upgrades. Download.com indicates that it distributes about 2.5 million KMD installers per week. From past experience Sharman is confident that virtually all users will upgrade over time, but cannot know precisely.

[1] All preceding versions of the software issued by Sharman Networks for the last year or so have included the option of free virus protection software (Bullguard), and have always included an adult content filter and options for users to control levels of privacy of their experience.

2. **Does current technology permit Kazaa to sample the content of files being shared by its users and compare these samples to an updated database of copyrighted material? Would Sharman Networks agree to incorporate such a filter into Kazaa if it were available?**

   Sharman Networks' Kazaa Media Desktop application does not sample or monitor, and is not equipped to sample or monitor, files that users of its application exchange. Sharman Networks is unaware of any technology that would reliably enable the monitoring of files exchanged between individual users of software containing FastTrack communications protocols.

   Even if it were technologically possible for large scale content sampling, Kazaa Media Desktop is a relatively simple software application that could not accommodate the massive database that would be required for immediate and concurrent comparisons to check for copyright and authorization status of files on this scale.

3. **Given that Sharman Networks can scan files that are being uploaded for certain virus signatures in order to protect its network, why can't Sharman scan files for hash marks associated with unauthorized copyrighted content?**

   Sharman is not aware of any software application that can scan files exchanged between users of the Kazaa Media Desktop application for hash marks associated with copyrighted files, or prevent users from searching for and exchanging such files. Sharman Networks itself does not scan files for viruses. Rather, Sharman's Kazaa Media Desktop application comes equipped with third-party anti-virus software which automatically provides for virus protection—much like a personal computer might come equipped with Norton anti-virus software already installed. Sharman does not write the anti-virus software

4. **There have been a large number of individuals in this country who have complained recently that they did not know that downloading copyrighted files on Kazaa is illegal. Many have said that they assumed since the service was available it must be legal. Some have even complained that their payment of $29.95 made them believe that they were now authorized to download whatever copyrighted files they wanted. Given this serious confusion, is Sharman Networks willing to place on the front of its website, and next to the search bar in its software, a warning that users should not download copyrighted files for which they do not have authorization?**

   There are clear warnings regarding activities and actions of users with regard to breach of copyright. These warnings *("Copyright: Sharman Networks Ltd does not condone activities and actions that breach the rights of copyright owners. As a Kazaa Media Desktop user you have agreed to abide by the end user license agreement and it is your responsibility to obey all laws governing copyright in each country.")* appear on every page of Kazaa Media Desktop, both on free and paid-for versions.

   In addition, users must agree explicitly to the End User License Agreement before the application can be downloaded, which includes clear warnings that Sharman does not condone activities and actions that are in breach of copyright.

   We note that complaints have been made by individuals who have paid a sum of money for what they believed was Kazaa. Kazaa Plus (Sharman's ad free version of Kazaa priced at $29.95) was only released on 28th August 2003 prior to which there was no paid for version of the software produced by Sharman Networks.

Sharman is aware of several well known instances of scams and hacks of its software. Sharman has witnessed that some of these dubious applications are offered to users at various prices, including that which is stated in your question. Therefore, it is evident that the actions of the RIAA have included individuals using these illegal applications. This is further evidence of the indiscriminate and unreliable methodology employed in the subpoenas issued to individuals by the RIAA as they falsely claim these are users of the Sharman software.

Kazaa Plus of course, unlike these scams and hacks, includes explicit warnings regarding users' obligations to respect copyright on both the web pages and the EULA that must be agreed to by users.

QUESTIONS SUBMITTED BY SENATOR CARL LEVIN,
Ranking Minority Member, Permanent Subcommittee on Investigations:

1. **You testified at the hearing that neither Sharman Networks, Ltd. nor Kazaa currently has the technical capacity to block from its file-sharing network a person who has already downloaded Kazaa software, even if that person were known to be misusing the Kazaa software to violate copyrights. Please explain why that blocking capacity was not included in the most recent version of the Kazaa software, and whether it will be included in future versions of the Kazaa software.**

   With regard to the question posed by Senator Levin in the hearing on the 30th September, Sharman responded that the application had no technological capacity to block individual users from the application itself; much in the same way that Microsoft cannot block individual users from using Internet Explorer, much less monitor every file or site that is visited. The blocking capacity referred to in the question above simply does not exist, despite inferences to the contrary.

   To clarify, Kazaa Media Desktop does not uniquely identify users, so there is no way to instruct the technology to ban certain users. The blocking technology referred to does not exist, making questions regarding its inclusion in the Kazaa software redundant.

2. **Did Sharman Networks, Ltd., Kazaa or any related entity or person build into any version of the Kazaa software the capacity to remotely modify that software after the software has been downloaded?**

   Kazaa Media Desktop has no way to be remotely modified after the software has been downloaded. The Kazaa Media Desktop is one large executable (.exe) file so the fundamental architecture will not allow any modification of KMD remotely.

   a. **If so, in which versions of the Kazaa software was that capacity included and about how many users are estimated to be using that version?**

      Not applicable. (NA)

b. **If so, please explain whether Sharman Networks would be willing to remotely modify that KaZaA software version to include the capacity to block a person from using KaZaA's file-sharing network if that person were found to be using the software to violate copyrights. If Sharman Networks is unwilling to take this action, please explain why.**

Not applicable. (NA)

3. **You testified at the hearing that Sharman Networks, Ltd., a company incorporated in Vanuatu, has already identified its owners in court filings under seal, and you would inform the Subcommittee about whether Sharman Networks, Ltd. would publicly disclose its ownership to the Subcommittee.**

   a. **Please identify the owners of Sharman Networks, Ltd., including the name of any trust, corporation, agent, or other entity holding a direct or indirect ownership interest in Sharman Networks, Ltd. For each such trust, corporation, agent, or other entity, please identify the name of the entity; the nature of the ownership interest held by such entity; the name of any trustee, director, shareholder, incorporator, or lawyer associated with such entity; and the name of any company or other entity in Vanuatu responsible for registering or administering the affairs of such entity or of Sharman Networks, Ltd.**

   b. **Please identify the ultimate beneficial owners of Sharman Networks, Ltd., meaning the natural human beings intended to benefit from the activities of this corporation, whether such persons hold a direct or indirect beneficial interest through a trust, corporation, agent, or other entity, or exercise direct or indirect control over Sharman Networks, Ltd. through a trust, corporation, agent or other entity. For each such human being, please provide the person's name and address and describe the nature of his or her relationship to Sharman Networks, Ltd.**

   On the advice of Sharman's legal counsel, Sharman is unable to provide this information. Due to the restrictions of the Vanuatu International Companies Act No. 32 of 1992, Part 15, Section 125, and the confidential nature of the information sought, Sharman requested the staff of Senator Carl Levin to provide a binding protective order or other assurance of confidentiality by which Sharman could disclose the information requested to the members of the Permanent Subcommittee on Investigations and simultaneously assure that the confidential information would not be publicly disclosed. Regrettably, Sharman received no response to this proposal.

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RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
SUBMITTED TO
CHRIS GLADWIN
Founder & Chief Operating Officer
FullAudio Corporation

QUESTIONS SUBMITTED BY SENATOR NORM COLEMAN
Chairman, Permanent Subcommittee on Investigations:

1. **Currently, is there technology available to peer-to-peer networks that can filter copyrighted work to prevent its illegal sharing? If so, please describe with specificity.**

   The technology required to identify and filter copyrighted material is readily available from a variety of sources. For example, Relatable of Alexandria, VA and Audible Magic of Los Gatos, CA each offer acoustic fingerprinting systems that compare digital songs to a database of copyrighted songs to determine if a particular song is a copyrighted work. To keep songs identified as copyrighted material from begin illegally shared, peer-to-peer software would simply publish as sharable only those files that had been identified as non-copyrighted materials.

QUESTIONS SUBMITTED BY SENATOR CARL LEVIN,
Ranking Minority Member, Permanent Subcommittee on Investigations:

1. **Is it common for a developer of online software to include in the software the capacity for the software to be remotely modified after it has been downloaded?**

   It is and has been common for many years for online software providers to include in their software the capacity to remotely modify their software after it has been downloaded. For example, anyone who has ever used AOL would be familiar with the automatic software updates that AOL performs to software that has been downloaded by its users. These updates are accompanied by a message like "Please wait while your software is updated." The vast majority of online software has a similar capability since this software update capability is easy to implement and is often required in order to keep online software working properly.

2. **Could a developer of file-sharing or peer-to-peer software (hereinafter "P2P software") include in that software the capacity for the P2P software to be remotely modified after it has been downloaded? Would developing such a mechanism in P2P software be technologically difficult or prohibitively expensive?**

   Since P2P software utilizes the Internet for its operation, that software is inherently able to communicate with the organization that originally developed the software to query for an access software updates. Developing and implementing such a capability is neither technologically difficult nor would it be prohibitively expensive in that the incremental costs are the few weeks that it would take a software engineer to create and test this capability. Automatic update

capability is already a common practice among software developers, such as AOL, Microsoft and others. This automatic update capability is also available from third party companies that offer installation software, such as InstallShield Software and Wise Solutions, Inc. Further, most P2P software already has built-in the ability to query for and automatically download updated advertising, namely banner ads. Automatically querying for, downloading then displaying new banner ads is technically very similar to automatically querying for, downloading then loading a new version of software.

3. **If a developer had included in on-line software the capacity to remotely modify it after it has been downloaded, would it be possible to remotely modify that software to include, in essence, a turn-off switch which, for example, in the case of P2P software, would enable the software developer or a network operation to block a software user from accessing the P2P network if they were using the software to violate copyrights?**

   It is technically practical and common industry practice for a software developer to include the capability to remotely turn-off software that has already been downloaded. A common way this capability is used is to turn off a customer who has not paid a monthly fee to use an online service. The same technology that enables an online service provider to turn off a customer who has not paid a monthly bill can be used to turn off a user of P2P software who uses that software to violate copyrights.

   Saying that P2P software does not have the ability to detect copyright violations and does not have the ability to perform automatic updates and does not have the ability to turn-off particular users is like saying that a car without a steering does not have the ability to turn. Yes, it is true that a car without a steering wheel cannot turn, but the only reason the car can't turn is because the creator of that car chose not to add a well understood and common technology – a steering wheel. Detecting copyrights violations, updating software and turning off software user who do not meet software license requirements are well understood and common technologies.

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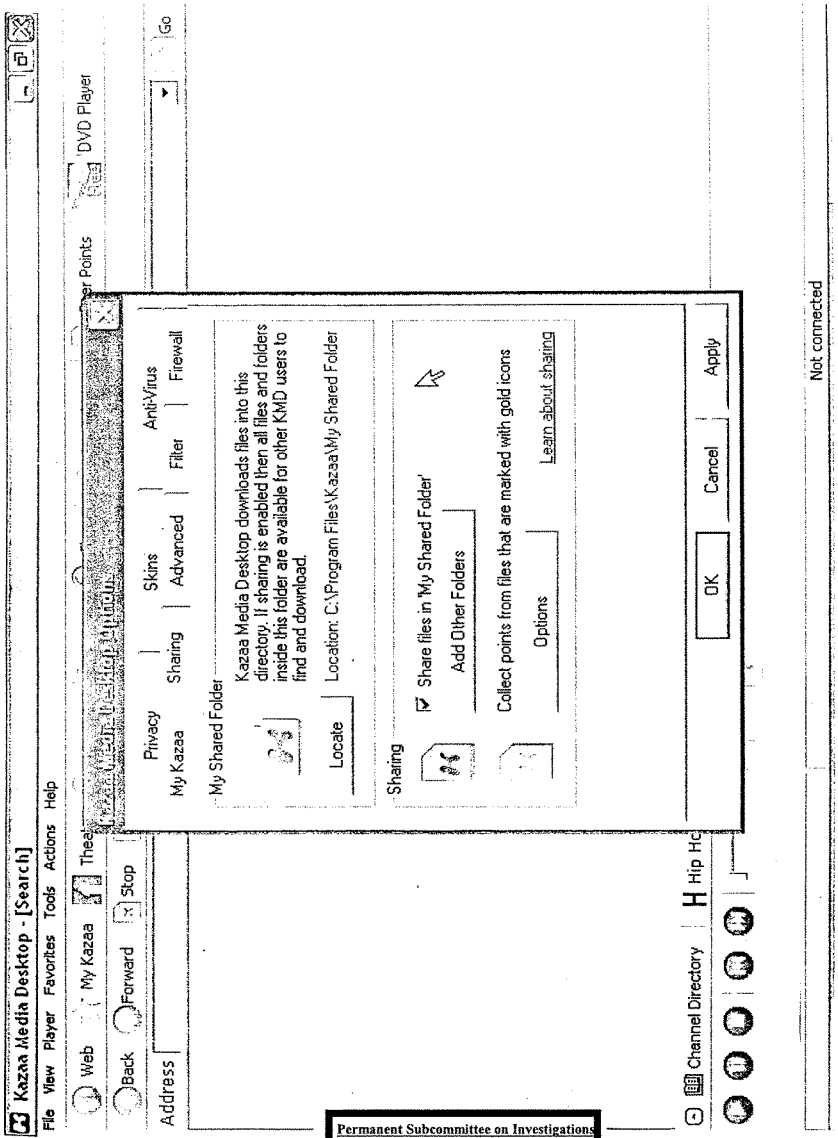
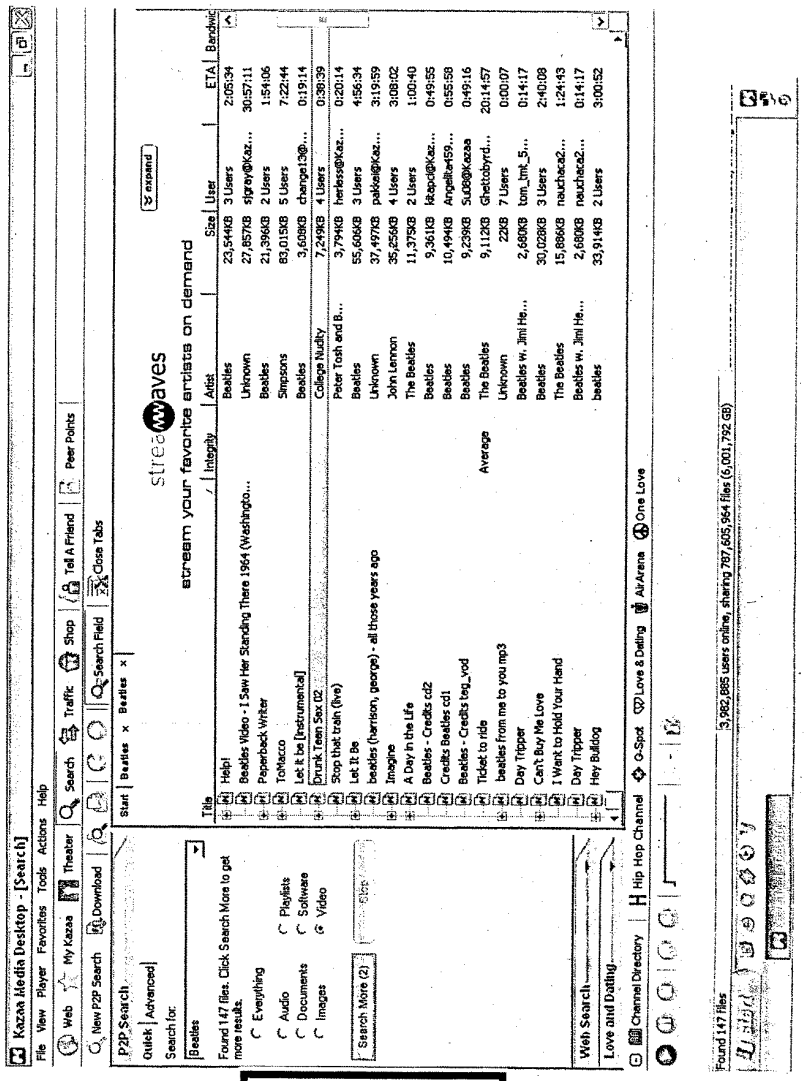


Permanent Subcommittee on Investigations
EXHIBIT #6a



Permanent Subcommittee on Investigations

EXHIBIT #6b