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PROTECTING COPYRIGHT AND INNOVATION IN A POST-GROKSTER WORLD

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

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PROTECTING COPYRIGHT AND INNOVATION IN A POST-GROKSTER WORLD

WEDNESDAY, SEPTEMBER 28, 2005

UNITED STATES SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Arlen Specter, Chairman of the Committee, presiding.

Present: Senators Specter, Cornyn, Leahy and Feinstein.

OPENING STATEMENT OF HON. ARLEN SPECTER, A U.S SENATOR FROM THE STATE OF PENNSYLVANIA

Chairman SPECTER. With all this quiet in the Judiciary Committee hearing room, without even the pounding of the gavel, it must signify that you are ready to begin this hearing. I haven't heard such an orderly assemblage in the 25 years I have been here before the Chairman signifies the start, but you saw it was 9:30 and recognized that, by precedent, this hearing is underway.

Our hearing today focuses on the recent Supreme Court decision in the case of *MGM* v. *Grokster*, and as articulated by the Court, the subject is the, quote, "tension between the competing values of supporting creativity through copyright protection and promoting technological innovation by limiting infringement liability."

The subject of copyright infringement and the promotion of creative and artistic endeavors was the focus of the Founding Fathers in Article 1, section 8, of the Constitution, where Congress was explicitly granted the power to regulate copyrights and patents for the promotion of exclusive rights to authors' creative activities on literary, dramatic, musical, artistic or intellectual works.

The Congress has not acted on the issue of the Internet and copyright infringement and secondary liability, but has really left it up to the court, which, candidly, is a major concern of mine. Congress has much more capabilities to deal in this field than does the court. We have the capacity to hold hearings, to make fact-findings, to listen to the competing complex issues on all sides, contrasted with the more limited approach of the court in the judicial proceedings.

But so often, as is the case, the Congress abdicates or defers to the court. We had the hearings on Guantanamo several weeks ago where, notwithstanding the express Congressional responsibility, nothing was done and the court came down with a series of opinions in June of 2004 and we are really on the sidelines, although we ought to be front and center.

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So this is a very important hearing, and in the absence of a constitutional issue, which we really don't have, Congress really ought to be making the judgment here. It goes without saying that we are very, very busy on many, many items. I don't have to enumerate them for this erudite group, but that is not a sufficient explanation as to why we await the judicial decisions.

I can recall back in the early 1980's on the VCRs, before we had the decision in *Sony* v. *Universal*, giants of the industry on both sides were camping outside of all the Judiciary Committee doors. I had a small hideaway on the west wing and had the multizillionaires seated on the steps outside the hideaway.

I am filibustering, Patrick.

Senator LEAHY. I appreciate that. You know how.

[Laughter.]

Chairman SPECTER. Only in hearings, not in confirmation proceedings.

[Laughter.]

Chairman SPECTER. Commenting back about the days of the Betamax, and I am sure you will remember how much in demand Judiciary Committee members were, with all the moguls of the industries competing. I had a small hideaway. Senator Leahy had a lot more seniority, so he was in some lofty perch somewhere. But they were sitting on the steps and I was a newly elected Senator and was sort of luxuriating in the power. All these big wheels were seated on the steps waiting to talk to me, and I didn't know anything about this subject anyway.

But we didn't act at that time and the Supreme Court came down with the decision, and now we have in the *Grokster* case the finding of secondary liability where there is a distribution, quote, "with the objective for promoting its use to infringe copyright, as shown by the clear expression or other affirmative steps taken to foster infringement," and that establishes the liability.

But, as usual, the concurring opinions throw some doubt as to what the standards are. Justice Breyer's definition of, quote, "substantial non-infringing uses," close quote, is measured by using a prospective analysis of future non-infringing uses of the product rather than a pure comparison of current infringing and non-infringing uses. Justice Ginsburg has a narrower view, saying substantial would depend on the consideration of the actual relative uses to come to an estimate of the infringing and non-infringing uses of the product.

I am hopeful that a new Chief Justice will stop the proliferation of concurring opinions so we have a better idea as to what the law is, but there is another illustration of the important role Congress could play.

I limit my 5 minutes, Senator Leahy, to the time when you arrived. So the red light has been on, unusually, for a minute and 14 seconds, and now I yield to you.

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

Senator LEAHY. Mr. Chairman, you can take all the time you want. You know that.

In talking about Betamax, I do recall that time, and Ms. Peters does very well, I am sure. She is our go-to expert up here. You know, there was so much of the debate that went on at that time. There was also the debate—and the Senator from Texas may recall reading about this, too—the movie industry was very upset about the ability to tape movies and said you have to do something to stop this kind of thing.

Well, of course, there is not a single movie that is made today without planning what they can do—probably not so much VHS tapes anymore; it is all DVD—what can they do in after-sales. In fact, many movies that are kind of clunkers at the box office make more in DVDs. I made the mistake of renting one the other night. God, it stunk, and I won't mention which one it was.

Peer-to-peer technology, of course, revolutionized the way we share all sorts of information. But, like any technology, it can be abused, and unfortunately it has been. And as with any technology, those who abuse it effectively prevent the technology from reaching its highest potential.

More than 5 years ago, we held our first hearing on peer-to-peer, beginning an important dialog with many of the people in the community about this. I have long been a champion of innovation. I have long deplored the fact that a few rogue peer-to-peer companies have hijacked the enormous potential of this technology.

I have high hopes as someone who loves music, as someone who is fascinated by technology and as someone who represents a State full of music and technology fans, that the emerging market for legitimate online music sales will prosper. I hope it does so quickly.

If you look in my library, it goes from Puccini to the Grateful Dead. It is eclectic in its ability to pick up anything I want anywhere. But my concern is that unless the problems of piracy and privacy are addressed, peer-to-peer will never realize its enormous potential to build online communities, to enhance network learning, and to make unprecedented amounts of material, both educational and entertaining—it is not just entertaining, but it is the educational ones—available worldwide.

I remain concerned about the privacy and security issues. Since the Supreme Court's decision in the *Grokster* case, the industry players have certainly had incentive to find ways to provide online music without promoting the theft of music online.

Last June, as the Chairman has mentioned, the Supreme Court unanimously held that someone who distributes a device for the purpose of promoting its use for infringing copyrights will be just as liable for the infringement as the third parties who do the actual, direct infringing. They emphasized that *Grokster*'s unlawful purpose was abundantly obvious.

We should all remember that it is people using technology who infringe copyrights. Technology itself is not the problem, and neither is technology alone the solution. Our goal has to be the responsible use of technology and the respectful treatment of intellectual property rights.

Our technologies may evolve, but the central principle of respect for rights and promotion for innovation has to remain constant. The balance between these is critical to maintaining our Nation's status as the world leader in intellectual property.

We have all heard a great deal about peer-to-peer networks. Now, we are hearing more about Web casting and satellite radio. We want consumers to enjoy the great diversity in music available. We just have to ensure they do it legally.

So I thank the witnesses who are here to herald this beginning in the world of online music. The potential is fascinating. We are not Luddites on this Committee. We want it to expand, but we also—and I can't emphasize enough I want to protect people's legitimate rights. Those who produce the material and have done the work and the innovation, oftentimes genius, deserve to have their rights protected.

[The prepared statement of Senator Leahy appears as a submission for the record.]

Thank you, Mr. Chairman.

Chairman SPECTER. Thank you very much, Senator Leahy.

Senator Cornyn, would you care to make an opening comment?

STATEMENT OF HON. JOHN CORNYN, A U.S. SENATOR FROM THE STATE OF TEXAS

Senator CORNYN. Thank you, Mr. Chairman. I will be brief. I want to express my gratitude to you for scheduling this important hearing. Like the hearing that you held last week regarding the decision of the Supreme Court in *Kelo* v. *City of New London*, this hearing focuses on the important issue of property rights, only this time the property right doesn't involve a home, but rather the property interests of artists and those who invested so much money to produce their artistic works so that we can all enjoy them.

One of the good things about this hearing is I learned that Senator Leahy, our distinguished Ranking Member, listens to the Grateful Dead. We learn more everyday about each other in this body.

Senator LEAHY. I might say I think I know the lyrics of almost all of the songs, and I have got to tell you at some of the concerts the lyrics tended to change, depending upon the mood of the Dead.

Senator CORNYN. I see the Ranking Member in a different light now than I did before.

[Laughter.]

Senator CORNYN. I appreciate him even more.

Unfortunately, as you know, Mr. Chairman and Senator Leahy, everyday literally millions of dollars in copyrighted materials are stolen online. This theft is no less wrong because it happens in cyberspace. Rather, it is putting thousands of Americans out of work and damaging one of the most important and vibrant sectors of the United States economy.

As the Court said in the *Grokster* case, because well over 100 million copies of the software in question are known to have been downloaded and billions of files are shared across networks each month, the probable scope of copyright infringement is staggering. *Grokster* and StreamCast are not, however, merely passive recipients of information about infringing use.

This is an issue that really we have addressed before, similar issues, on a bipartisan basis, and I am sure we will continue to do that in this difficult area to try to strike the right balance. Senator Feinstein and I were proud to cosponsor the Artists Rights and

Theft Prevention Act, which we passed in the 108th Congress, which had to do with piracy of films, movies and other copyrighted materials even before copyright owners have had the opportunity to market their products. With the help of Senators Hatch and Leahy, that bill became law earlier this year as part of the Family Entertainment and Copyright Act. I am also pleased to be working with Senator Leahy, our Ranking Member, and other colleagues on additional legislation that will protect against rampant counterfeiting.

In closing, Mr. Chairman, let me just say that as we consider additional legislative measures and as we observe the implications of the Court's ruling in *MGM* v. *Grokster*, we must ensure that the advent of the Internet and the expansion of innovative technologies do not set aside the basic principles that theft is wrong and that facilitation of theft is equally wrong.

Thank you, Mr. Chairman.

[The prepared statement of Senator Cornyn appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Senator Cornyn.

We now turn to the United States Register of Copyrights, Marybeth Peters, who has held that position since 1994, and for 11 years prior was the policy planning adviser to the Register. So that is quite a distinguished tenure in that office.

She has been a lecturer at Catholic University and an adjunct professor of copyright law at the University of Miami School of Law and Georgetown Law. He has her undergraduate degree from Rhode Island College and a law degree with honors from G.W.

Thank you for joining us, Ms. Peters, and the floor is yours.

STATEMENT OF MARYBETH PETERS, REGISTER OF COPYRIGHTS, LIBRARY OF CONGRESS, U.S. COPYRIGHT OFFICE, WASHINGTON, D.C.

Ms. PETERS. Chairman Specter, Senator Leahy, members of the Committee, thank you for the opportunity to testify on protecting copyright and innovation in a post-*Grokster* world.

The recent ruling in the *Grokster* case, one of the most significant developments in copyright law in the past 20 years, clarified that those who offer products and services in a way that induces others to engage in copyright infringement can be held secondarily liable for that infringement. That clarification appears to have encouraged productive negotiations and agreements within the music industry and ultimately should make it easier to legitimately obtain music online.

The *Grokster* ruling has also raised the public consciousness as to the legal status of unauthorized peer-to-peer file-sharing of copyrighted works. In *Grokster*, the Court made clear that regardless of whether a product is capable of substantial, non-infringing use, one who offers such as product with an intent to induce to use it to infringe copyrights will be liable for the resulting infringement.

As the Court put it, one who distributes a device with the objective of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for resulting acts of infringement by third parties. The

Court made this ruling in a specific factual and legal context that is worth noting.

Ever since the rise of Napster in the late 1990s, creators and performers of music, motion pictures and other creative works have faced an unprecedented threat to their livelihoods as a series of so-called file-sharing services have risen to create and serve a market from massive copyright infringement. Millions and millions of people flocked to these peer-to-peer services to get free music, free movies and free other creative works, apparently without giving a thought to the fact that not only were they engaging in copyright infringement, but they were also undermining the very incentive for authors and artists to create the works that they were so eager to obtain.

Grokster and StreamCast clearly knew what their services were being used for, and as the litigation revealed, they consciously set out to exploit the market for infringement and to promote the use of their software for that purpose. But they were able to assert a plausible legal defense by relying on the *Sony* case involving the sale of VCRs, which was decided long before the Internet made it possible to engage in massive, instantaneous and virtually cost-free infringement.

In *Sony*, the Court held that there could be no liability for contributory infringement based solely on the distribution of a product that is capable of commercially significant non-infringing uses. The peer-to-peer services, supported by others in the consumer electronics and technology industries, asserted all the way to the Supreme Court that because peer-to-peer software is capable of substantial non-infringing uses, and because even those particular peer-to-peer services could be used for the reproduction and distribution of works in the public domain or of copyrighted works with the permission of the copyright owner, they were shielded from liability under the *Sony* doctrine.

If their arguments had prevailed, the continued existence of our creative industries, as well as our copyright law, would have faced a potentially mortal threat. Fortunately, the Court rejected such a drastic reading of *Sony* and made clear that whether or not a product has substantial non-infringing uses, one who distributes it with the intent that it be used to infringe and who takes steps to promote its use to infringe will be liable when infringement takes place.

Last year, Senators Hatch and Leahy introduced the Induce Act which would have made it unlawful to intentionally induce an act of copyright infringement. The Supreme Court's ruling comes close to accomplishing the intent of that Act.

It may be that in a few years either copyright owners or technology providers, or both, will conclude that *Grokster* did not achieve the right balance or that further clarification of the *Sony* rule is necessary. But we need to give lower courts some time to digest this ruling and give the affected parties time to see how clearly it offers guidance for both copyright owners and technology providers, and how good that guidance turns out to be. At this time, it is premature to consider the need for any legislation on secondary liability.

You should, however, now reform Section 115 of the Copyright Act, the compulsory license for reproducing and distributing phonorecords of musical works. *Grokster* gives copyright owners and legitimate music services a useful tool in the fight against peer-to-peer piracy, but that battle will not be won unless consumers are able to find the music they want online from legitimate services that offer convenience, security and reasonable prices. Section 115 is out of date and little headway has been made during the past 2 years of discussions about reform. Legislative action is needed now.

To conclude, first, I am hopeful that *Grokster* represents the turning point where legitimate online delivery services can supplant the illegal services that have dominated the online music scene. Second, I urge you to make reform of Section 115 of the copyright law a legislative priority for the 109th Congress, and I look forward to working with you to help that come about.

Thank you.

[The prepared statement of Ms. Peters appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Ms. Peters.

Our next witness is the United States Attorney for the Central District of California, Debra Wong Yang, the first Asian-American woman to serve as a United States Attorney, and has the largest office outside of Washington, D.C. She was appointed by the Attorney General to Chair the Attorney General's Advisory Committee on Cyber/Intellectual Property and the Intellectual Property Task Force. She had been a California State judge and an adjunct professor at USC. Her law degree is from Boston College.

Thank you very much for coming in today, Ms. Yang, and we look forward to your testimony.

STATEMENT OF HON. DEBRA WONG YANG, UNITED STATES ATTORNEY, CENTRAL DISTRICT OF CALIFORNIA, AND CHAIR, ATTORNEY GENERAL'S ADVISORY COMMITTEE ON CYBER/INTELLECTUAL PROPERTY, LOS ANGELES, CALIFORNIA

Ms. YANG. Thank you, Chairman Specter, Ranking Member Leahy, Senator Feinstein, Senator Cornyn, Good morning. Thank you for the opportunity to discuss the Supreme Court's recent decision in *Grokster*, and more broadly to talk about the Justice Department's efforts in protecting intellectual property.

Until relatively recently, protection of intellectual property has largely been a civil matter. Congress has made civil remedies available and left it to private parties to sue one another for damages or equitable relief. *Grokster* involves the reach of civil liability for copyright. There, the Court held that a person could be secondarily liable for a third person's copyright infringement, but only if he acted with the intent to promote the unlawful infringement. What I would like to discuss, however, is what the Justice Department is doing to enforce the criminal laws protecting intellectual property.

Congress has created criminal penalties only recently. Copyright and trademark infringement did not become felonies until the 1980s, and theft of trade secrets was not criminal until 1996. Patent infringement to this day is protected only by civil liability. The

resort to criminal sanctions has paralleled the growing importance of intellectual property to our economy.

In our mission to protect intellectual property, the Justice Department has focused on three goals. First, we have been using the tools that Congress has provided to halt the supply of illegally obtained intellectual property. Second, we have attempted to diminish the demand for pirated and stolen intellectual property through educational and outreach programs. And, lastly, we have trained and rely upon a group of prosecutors who specialize in cyber and intellectual property crimes.

In stemming the supply, we have investigated and prosecuted the initial theft of intellectual property assets, as well as their subsequent distribution. For example, we have identified three ways in which movies not yet available in DVD format are obtained. They are stolen from post-production facilities, they are handed off by persons who screen movies for the Academy Awards, or they are taped by camcorders. We have aggressively prosecuted criminals who engage in all of these acts.

Just this year, Congress substantially aided our ability to stop the supply of so-called pre-release movies by elevating the acts of uploading and of camcording from misdemeanors to felonies. U.S. Attorneys' offices across the Nation have already started to use these new statutes.

We have also attacked the distribution networks used by those who steal and pirate intellectual property. For those who distribute using the Internet, we use the Digital Millennium Copyright Act to prosecute individuals who dismantle the copyright protection attached to intellectual property assets.

We have also conducted several long-term investigations aimed at infiltrating and taking down groups that share pirated software and movies over the Internet. For example, earlier this year we had Operation Site Down. The Department of Justice took aim at a so-called warez group that operated a centralized data base containing more than $50 million in illegally copied intellectual property assets.

We have also started to investigate and prosecute more decentralized pirating organizations that use the peer-to-peer networks to store and distribute illegally obtained intellectual property. I have outlined several of these examples in my written submission to this Committee.

We have also targeted groups that distribute intellectual property in the real world by making hard copies of DVDs, CDs and software, and selling those items at swap meets and on street corners across the United States. Last year, for instance, U.S. Attorneys' offices in California and the State of Washington completed Operation Marauder and charged 12 people with copyright and trademark violations based on their mass production and distribution of illegal software in several different States in one of the largest seizures of counterfeit software in United States history.

In addition to these prosecutions, the Department has contributed to the administration's STOP program, which stands for Strategy Targeting Organized Piracy. Working with the White House, the Department of State and other departments within the Government, the Justice Department has met with representatives

from other countries to halt the influx of pirated items into the United States.

In addition to working to halt the supply, we have also devoted substantial time and effort to diminishing the demand for pirated intellectual property. Over the past year, we have hosted several different outreach programs aimed at high school students to educate them about why they should not download illegally obtained music, games and movies. We will continue to work on changing the attitudes about piracy through our extensive educational efforts.

The Department's efforts in halting the supply and demand for illegally pirated goods have been aided in large part by the Department's commitment to developing specialized prosecutors. The Department is now home to a 35-person attorney unit called the Computer Crime and Intellectual Property Section, known as CCIPS here at Main Justice, and have specialized units known as CHIP units, which stand for Computer Hacking and Intellectual Property units, that prosecute cyber and intellectual property crimes in 18 United States Attorneys' offices, as well as one CHIP prosecutor in each of the remaining U.S. Attorneys' offices.

Last year, then-Attorney General Ashcroft commissioned an Intellectual Property Task Force to conduct a comprehensive 6-month review of the Department's efforts to protect intellectual property. In October of last year, the task force published its report, with several concrete proposals to increase the Department's effectiveness in prosecuting these types of crimes.

Attorney General Alberto Gonzales has reaffirmed the Department's commitment to these issues when he recommissioned the task force to implement the recommendations. The Department has already put several of these recommendations into practice, which are set forth also in my written testimony.

Finally, Attorney General Gonzales recently created a subcommittee of United States Attorneys to examine what the Department can do to improve its prosecutorial efforts in protecting intellectual property. I have been asked to chair this subcommittee. Our subcommittee is just beginning its work.

I am grateful for the opportunity to address this cCommittee and I am hopeful that today marks the beginning of a fruitful dialog between our new Committee and Congress as to how to best combat the misuse of our Nation's intellectual capital.

Thank you, and I would welcome any questions.

[The prepared statement of Ms. Yang appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Ms. Yang.

Without objection, Senator Cornyn's statement will be made a part of the record, as will all other statements submitted, including Senator Feinstein's, Senator Leahy's, mine, and all of the witnesses'. Their statements will be made a part of the record.

Ms. Peters, you have been in the Register's office now for some 22 years. We would be interested in your views as to whether the definition of secondary liability and interpretation of the copyright laws generally might better be the function of Congressional hearings and legislation than Supreme Court decisions. What do you think?

Ms. PETERS. Having had a good Supreme Court decision recently—

Chairman SPECTER. How do you tell whether it is good or not?

Ms. PETERS. I know, I know. In this case, basically finding that there was liability was a good decision, and finding that those who consciously induce those others to infringe should be liable is a good result.

Chairman SPECTER. OK, so it was a good decision. Could Congress give you a better one? You know, we don't have concurring opinions when we legislate.

Ms. PETERS. I know, and we actually favor one of the concurring opinions over the other. But as I mentioned, Senators Leahy and Hatch last year did introduce the Induce Act, and if you look at the provisions in their Act and you look at what the Supreme Court did, they are remarkably similar.

Chairman SPECTER. So the Court just copied Justice Leahy and Justice Hatch?

[Laughter.]

Ms. PETERS. Well, in many ways it is—I will use the words "remarkably similar."

Chairman SPECTER. You know, they haven't even been confirmed.

[Laughter.]

Senator LEAHY. And probably never could be.

Ms. PETERS. I still believe that the common law system of secondary liability, in general, has served copyright rather well. And it may be that legislation should be enacted, but my own preference would be to see how courts deal with this at this point in time, and that could better inform any legislative fix because ultimately what you are looking at is the exact same thing that the Supreme Court did.

Chairman SPECTER. Well, I can understand your saying we have a Supreme Court decision and let's see how it works out now. But institutionally, isn't it really more of a Congressional function than a judicial function?

Ms. PETERS. I actually believe it is both. Because the Copyright Office is totally governed by—

Chairman SPECTER. It is both, exactly the same, tied, not more one than the other?

Ms. PETERS. Certainly, if there is legislation that is a clear intent of what the Constitution intended with regard to the Constitution gives the power to Congress to determine the scope of copyright protection. But that is not totally exclusive, and even when Congress acts, the courts in a common law system interpret that legislation. So it always is kind of back and forth between the Congress and the courts, each one basically supplementing the other in various situations.

Chairman SPECTER. Ms. Yang, in terms of the volume of the piracy and the losses, how would you compare the copying of cassette tapes and movie tapes, which had been the principal lines of infringement in the past, with the infringement available now with the technological advances and specifically the Internet? Is it a great deal more now than before?

Ms. YANG. I would say so, Senator. With respect to the volume, because of the availability and the access of sharing on an Internet site, a warez site or on a peer-to-peer level, it is astronomical as far as how much can get out there and how quickly it can be done.

There is one small distinction, though. With respect to the hard goods, the one difference is you actually exchange cash. So there is somebody who is out there who is taking monies in when it comes to hard goods. It is much more difficult for us to quantify what that loss would be in sort of the peer-to-peer or the Internet situation.

Chairman SPECTER. Ms. Yang, we have the concurring opinions which are present in the *Grokster* case. Would it be important for Congress to pick up at least the issues raised in those two concurring opinions and consider them and to legislate in that area so the district courts know what the law is and won't go back and forth like a tennis ball between the concurring opinions?

Ms. YANG. First, Senator, I would like to make the distinction that *Grokster* relates solely to civil liabilities and civil issues, and I am here to sort of address the criminal aspects. But anytime you have an opinion where there are, I guess, questions left for litigants and parties to have to muddle through, it is always helpful to have legislation in that regard, and especially in this particular area as we course through rapidly changing times.

Chairman SPECTER. My red light went on in the middle of your answer, so I yield now to my distinguished colleague, Senator Leahy.

Senator LEAHY. Thank you, Mr. Chairman.

Ms. Wong Yang, I am glad to have you here. Ms. Peters, of course, probably has the record of having appeared before this Committee more than virtually anybody else and, of course, has testified on this subject before.

Could I ask you—I understand the various parties in the music industry have been negotiating among themselves. Have you taken part in those discussions?

Ms. PETERS. We took part in the summer of 2004 and reported to the House subcommittee on the results of those meetings. We certainly have been aware of the discussions between the private parties, and I did actually testify before the House and people commented on my remarks.

At the moment, we have met with most of the players and they seem to be at an impasse, but the bottom line is, yes, we have been very actively involved. We don't have a stake necessarily in a particular outcome. The goal is to make sure that there is sufficient licensing so that legitimate services can blossom and flourish.

Senator LEAHY. What happens if we don't legislate a change in Section 115?

Ms. PETERS. Then you have the status quo. So to the extent that there are people who are complaining that it is impossible to use the compulsory license or that it is impossible to license in the current environment, then that will continue.

Senator LEAHY. What about those millions of people who have still got that old software? There are millions of people out there with the old software. They are still exchanging stuff. What do you do about that?

Ms. PETERS. I think that the Supreme Court—

Senator LEAHY. Is that horse out of the barn?

Ms. PETERS. There will always be people who disobey the law. I do believe that because of the Supreme Court decision, more people know that there is no question about the legality of the various actions. So I do think those people who may have been tricked into thinking that what they were doing was legal know better. So I think ultimately it will be reduced, but it will never go away.

Senator LEAHY. Thank you.

Ms. Wong Yang, Senator Hatch and I introduced the Pirate Act last year. That is sort of the civil side of the Justice Department's criminal enforcement authority in the copyright realm. Now, as I understand it, the Department did not support the effort of Senator Hatch and myself. You have also suggested very strongly that you believe the enforcement of intellectual property rights in a civil context has to be left to private parties. I am somewhat puzzled by this because the Federal Government, especially this Justice Department, has no hesitation in bringing civil cases in a lot of other areas where they assume the public interest requires it.

Is there any reason why we should limit the Federal law enforcement of copyright laws just to the most egregious criminal cases? Couldn't civil litigation accomplish sometimes quicker and better what you might want to do?

Ms. YANG. Certainly, Senator Leahy, I think that where you have parties who can seek civil liabilities against each other, that provides a certain amount of compensation for the loss. What we try to do with our limited resources is try to attack those who actually distribute or supply to a greater magnitude and try to use our efforts to focus on, much as we do in drug cases, those that are sort of in the chain and distributing it. We can't necessarily get at all aspects of it and try to sort of focus our efforts in that regard.

Senator LEAHY. I can never fully understand just why the Justice Department does some things they do. I know right after 9/11, a lot of us were concerned about ships coming into the New Orleans port and the Department of Justice spent a lot of money on a huge investigation down in New Orleans, and guess what they found. Two houses of prostitution. I mean, who knew in New Orleans, of all places?

[Laughter.]

Senator LEAHY. I would think they could have gone to the Yellow Pages and found them a lot faster.

[Laughter.]

Senator LEAHY. How does the Department combat physical piracy? How is it handling the problem overseas? What resources are allocated to peer-to-peer prosecutions and how successful have those prosecutions been?

Ms. YANG. Aside from the STOP program that I referred to earlier, the Department actually in the Intellectual Property Task Force report identified a number of things that we could do in the future with respect to dealing with some of the foreign problems.

One of them is to put a prosecutor located in Eastern Europe and another one in Asia to help facilitate the processing of more of those crimes, and we continue to do outreach through various organizations into those countries.

Senator LEAHY. Thank you. I think I will have some follow-up questions. I will submit them in writing, though, on that. Thank you very much, Ms. Wong Yang. Thank you, Ms. Peters.

Mr. Yang. Thank you, Senator.

Chairman SPECTER. Thank you, Senator Leahy.

Senator Feinstein.

STATEMENT OF HON. DIANNE FEINSTEIN, A U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator FEINSTEIN. Thank you very much, Mr. Chairman. As you probably know, this is a major issue for my State. We have all seven of the big movie companies, hundreds of independents, a whole chain of companies that function legally.

I have watched for over half a decade now, beginning with Jack Valenti coming before this Committee and urging us to do something. We then asked Jack to go out and negotiate and there was an attempt at negotiation, and then there was another attempt at negotiation. Some companies, I believe, have changed.

We now have a unanimous Supreme Court decision, and yet the peer-to-peer networks are apparently increasing rather than decreasing. To me, that is a signal, and the signal is that we should enact a strong law to protect our copyright industries. If these negotiations can't produce, then I think it is up to the Congress to act.

I know that the United States Attorney here, Ms. Yang, operates the largest U.S. Attorney office in the Nation in the center of much of the intellectual property industries of California.

If we were to legislate, Ms. Yang, what would you advise us to do?

Ms. YANG. Senator, I can't answer that specifically today. I will tell you that the legislation that you have provided to us in the past with the Family Entertainment and Copyright Act we have been using in the U.S. Attorneys' offices. One case was filed—actually, all of them have been filed in your jurisdiction. One was filed in San Jose, and just yesterday down in Los Angeles we filed a case charging eight individuals using that violation where they uploaded onto the Internet.

On the subcommittee that I just got named to chair, what we hope to do is identify various holes and places where we see things in our prosecutions that we could identify as being areas where we could use the assistance from this Committee and from the Senate.

Senator FEINSTEIN. Well, you see, I would think in view of a unanimous U.S. Supreme Court decision, which is actually being followed in other countries—and we are constantly told stop to piracy in China. Well, how can you stop piracy in China when we can't stop it in our own country? We have got that Supreme Court decision and still the illegality exists. I think what is necessary is really forceful enforcement tools. If you don't have them, I think we ought to give them to you.

Ms. YANG. Right. I mean, for example, when you increased the penalties in camcording from misdemeanors and allowed us to charge it as a felony, I think that sent a strong deterrent message through the entertainment—

Senator FEINSTEIN. Then why are these illegal networks still out there if the message is so strong?

Ms. YANG. I think the message needs to come out even stronger. We need to get out there with a unified voice. From the Department's perspective, that is what we tried to identify through the Intellectual Property Task Force and identify areas that we could hit on. We have been charging cases in the peer-to-peer area, but quite frankly there is only so much that we can do in a limited amount of time.

Senator FEINSTEIN. My point is, Mr. Chairman, whatever it is, it is not enough. How can you have a U.S. Supreme Court opinion which is unanimous which carries the full force of the legal system in this country and yet it still goes on, and it goes on to the extent of considerable loss to legitimate companies with copyright rights? So my view is that whatever the message that is going out there is, it isn't strong enough and that this Congress needs to take some action.

I remember when Valenti first came before us and they started the negotiations, and it has gone on and on and on probably for close to a decade now. Yet, still the illegal market is increasing, and there seems to be no sanction and no deterrent that slows it down sufficiently.

Chairman SPECTER. Well, we have the United States Attorney here from the Central District of California.

Senator FEINSTEIN. Who is saying she does what she can when she can do it. That is the way I interpret what you are saying, and what I am saying back is it isn't enough. So what do we need to do to give you the tools? That is what I want to know, if you don't have the tools.

Ms. YANG. Senator, I would actually like to—I don't want to speak off the cuff here. I would like to sort of caucus with people back at Main Justice and see if there are things that we can identify or make specific suggestions to you, because I know that is what you are asking for.

I will tell you that the education that we have been doing is a large component, and it is very dismaying for me to go into the public among high school students, college students, some of the places where I lecture to students, and ask them how many of you download music or movies. I give them a 10-second immunity to answer the question and almost always it is a hundred percent of the people in the room. So I mean that is part of the reason why we also have to educate our youth as to why this is actually a theft.

Senator FEINSTEIN. Just bottom line, we either have copyright that we enforce, or because you have got this broad young public that sees nothing wrong with illegal downloading, you destroy every copyright industry, it seems to me. Every industry that depends on copyright can't function in a country as the high-tech services become such that you can't protect copyright. And that is what I see happening now, and it will spread to other areas, as well. So somehow we either get a handle on it and stop it—and I think the only way to stop it is through the peer-to-peer network by really sanctioning it in a way that either it is going to be legal or it isn't going to exist.

That is the difficult part. How do we give you the tools to do that, because the market is going to remain, just as the market for illegal products in China and all over the world is going to remain? And it seems to me if we can't stop it on our own shores, we can't tell other countries what to do or not do.

Ms. YANG. I agree.

Chairman SPECTER. Well, Ms. Yang, aren't there existing criminal penalties available to go after those who are secondarily liable?

Ms. YANG. There are. I mean, post-*Grokster*, we did one case where we took down some peer-to-peer individuals and we continue to do that. It is just that for us—

Chairman SPECTER. One case?

Ms. YANG. Yes, we have done one case.

Chairman SPECTER. How about more than one case?

Ms. YANG. Well, part of that, sir, has to do with the fact that our mind set really is—and it is not to say that we ignore that. That is not it at all, but our mind set is trying to get at the people who directly distribute and supply the goods. So we are still going at sort of, as you call it, the first level. So for us to drop down to those who are, as we call it, secondarily liable—you know, it falls within the focus if it is of great magnitude, but quite frankly we are still operating at the first level.

Senator FEINSTEIN. I think—

Chairman SPECTER. Well, wait a minute. Why not operate at both levels? How much consultation is necessary with Main Justice? You have criminal liability under the statute. You have a definition now by the Supreme Court as to secondary liability. Why not get tough? That is what Senator Feinstein wants you to do and I think she has got a pretty good idea.

Ms. YANG. I could do that if I could take, for example, many more prosecutors and put them toward doing that.

Chairman SPECTER. So you need many more prosecutors? Tell us what you need. That is the pending question by Senator Feinstein.

Ms. YANG. Quite frankly, you know, the things where there are resources involved, that would definitely help because, you know, we are trying to manage, quite frankly, a lot of different things right now. Terrorism is our Number one priority, as well it should be, and unfortunately we have those kinds of cases that actively go on in my district.

Chairman SPECTER. Is there any room for private prosecution of the injured parties to go into criminal court?

Ms. YANG. Certainly, there could be cross-overs. I mean, we would never want to be sort of, I guess, the hammer in a civil lawsuit, so to speak. So where civil remedies are available and they are adequate, that is fine.

Chairman SPECTER. I am not thinking about civil liability. There are some provisions in the criminal law for private prosecution. There was a very good analysis of that in the Yale Law Review some years ago that I wrote.

[Laughter.]

Chairman SPECTER. Senator Feinstein.

Senator FEINSTEIN. If I might just say something, the thing that worries me is if we go out and arrest some high school that is downloading—and I don't think any of us are supportive of that,

but you have got very smart, very sophisticated people running these networks. They know what the liability is and they take the chance, and I think, candidly speaking, it has got to be either made legal or shut down.

What bothers me is the information I have received that it is increasing, despite the Supreme Court decision, which indicates to me that we have got a real problem on our hands and that if we don't stop it, it is going to destroy these intellectual property industries.

Chairman SPECTER. Well, you have your assignment, Ms. Yang: off to Main Justice and report back this afternoon.

[Laughter.]

Chairman SPECTER. Ms. Peters, we could use some help from you, too. With your 22 years' experience, you must have some ideas. Consider the question to be submitted in writing within a week: what active steps can Congress take to help law enforcement with additional resources and what additional legislation is necessary, if any, to enforce the laws.

Now, on to panel two. Our second panel consists of Mr. Marty Roe, Mr. Cary Sherman, Mr. Gary Shapiro, Mr. Mark Lemley, Mr. Ali Aydar and Mr. Sam Yagan.

Marty Roe is our first witness on panel two. He is the lead singer and guitarist for the country music group Diamond Rio. No. 1 hits include "Meet in the Middle," "Beautiful Mess," "One More Day," and "How Your Love Makes Me Feel." The band has won four country music awards and was inducted into the Grand Ole Opry in 1998.

Thank you for joining us, Mr. Roe, and the floor is yours.

STATEMENT OF MARTY ROE, LEAD SINGER, DIAMOND RIO, NASHVILLE, TENNESSEE

Mr. ROE. Thank you, Mr. Chairman, Senator Leahy and Members of the Committee. Good morning. I am Marty Roe, with the group Diamond Rio. I would like to introduce my band mates who are here somewhere: Gene Johnson, who is from Pennsylvania; Dan Truman, from Utah; and Dana Williams, who is from Tennessee. Somehow or another, they elected me for this honor. We do appreciate the opportunity to speak today to give you an artist's perspective on the Supreme Court's recent *Grokster* decision.

We have been signed to Arista Records since 1991 and are blessed to have a career that has spanned well over a decade. I am proud to say that we made history this year with our 15th consecutive Country Music Association Vocal Group of the Year nomination, and I am proud and honored to be here this morning representing the music community.

Imagine going to your job 8 hours a day, 5 days a week, 50 weeks a year, working hard to produce a product that you are proud of that adds value to society. Now, imagine that at the end of that year, you receive no paycheck and no compensation from the millions of people who use everyday that product that you worked so hard to create. You would have walked off that job long ago.

Unfortunately, that is exactly what has happened in the music industry, not because of any lack of love for music, but for the simple truth that artists and songwriters, like everyone, need to make

a living. Many peer-to-peer services like *Grokster* have been the main culprit in preventing those artists from making a living. By operating file-sharing networks, encouraging and facilitating the free exchange of millions of copyrighted works, these businesses have devalued our music and created an entire generation of listeners who believe that we don't deserve to be paid for our hard work and creativity.

The result can be seen from Music Row to Hollywood as artists, musicians and songwriters have closed up shop. Some have estimated that the Nashville community has lost nearly half of its songwriters, a huge number of whom have been forced to go into other professions in this terrain.

The Supreme Court's decision in *Grokster* offered a unique high note in this otherwise downbeat time. The highest court in the land, in a unanimous decision, saw what we saw, what nearly everyone who seriously considered this issue saw: this was outright theft, and *Grokster* and other services like it were making it happen. The decision gives new hope to a suffering industry by making those services responsible for promoting the theft of our creative work. It shines a spotlight on shady businesses that have perfected the art of operating in the shadows and blaming others for the resulting illegal activity.

Certainly, some bands have used peer-to-peer networks to market themselves and reach a wider audience. If this has worked for them, that is great, but this promotional device should be a choice for each and every artist. No one should decide for me or any other band that a song should be offered for free.

Of course, Diamond Rio is excited to be a part of the digital revolution. We embrace it. For instance, our music is offered on the current Napster, iTunes, Music Match and many more, but these services present a major distinction from *Grokster* and its siblings. They value our music and encourage others to value it as well. For a reasonable fee, the public can get quality downloads without the threat of viruses and spyware. Appropriate payment goes to us and the many people who help us bring our music to you. The *Grokster* decision is important in helping to continue to usher in legitimate online music businesses and a vibrant, legitimate marketplace.

We are part of a large family, an interconnected network of artists, songwriters, musicians, recording engineers and many others who bring music to life. We have been proud to work in Nashville, the heart of music-making in the country, and indeed in the world. We want to see this family survive and grow, and the *Grokster* decision has played a major part in that. The *Grokster* decision was helpful because a unanimous Supreme Court set the tone of intolerance for using piracy as a business tool to make profits at the expense of artists.

Regardless of the medium, whether it be peer-to-peer, radio, downloads, satellite, Internet or any other platform, we hope that Congress will work vigilantly to maintain and assure this tone of intolerance against businesses facilitating theft, because by doing so you will be helping those of us who devote our whole lives to making the music.

Thank you.

[The prepared statement of Mr. Roe appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Mr. Roe.

Our next witness is Mr. Cary Sherman, President of the Recording Industry Association of America, 350 members. It purportedly represents the interests of a $14 billion U.S. sound recording industry. Prior to his current position, he was a partner in Arnold and Porter, and a graduate of Cornell and the Harvard Law School.

Thank you for coming in today, Mr. Sherman, and we look forward to your testimony.

STATEMENT OF CARY SHERMAN, PRESIDENT, RECORDING INDUSTRY ASSOCIATION OF AMERICA, WASHINGTON, D.C.

Mr. SHERMAN. Thank you, Mr. Chairman and Senator Leahy and Senator Feinstein. I appreciate the opportunity to testify today. I think that that must be an old bio because a $14 billion is now a $12 billion industry partly because of the subject matter of today's hearing.

Clearly, the decision in *Grokster* was a defining moment for the distribution of music and other creative content in the digital age. In a rare unanimous decision, the Court recognized that those who actively induce or encourage others to steal copyrighted works may be held liable themselves for the resulting infringement. And I would like to recognize this Committee's leadership in helping forge the path taken by the Supreme Court in the *Grokster* case. The language of the opinion may be legalese to many, but the message was simple: theft in any medium is unacceptable and those who facilitate it may be held responsible.

The music industry has been hit particularly hard by the massive theft occurring on illicit P2P file-sharing networks like *Grokster*. Record companies are essentially venture capitalists, with the revenue we earn from the sale of recorded music plowed back into new music and new artists. Unfortunately, there is a lot less money to invest these days. SoundScan recently reported that through the week of September of this year, album sales are down 8 1/2 percent versus the same period for 2004, and this is on top of a 5-year decline of some 30 percent on units shipped between 1999 and 2004. The result is less money to invest in new artists and new music.

Thousands of individuals engaged in the music, film and other entertainment industries have seen their jobs disappear, and music stores across the country have had to close their doors. Left unchecked, the networks that promoted this illicit activity threaten to instill in an entire generation a culture of lawlessness and a complete lack of respect for copyright and the valuable works it protects.

The decision in *Grokster* helps to change all that, clarifying that inducing and encouraging infringement are just as much a part of copyright law as the doctrines of contributory infringement and vicarious liability. This result is completely consistent with and does nothing to change the holding of the landmark *Sony Betamax* case, which the Court noted was never meant to foreclose rules of fault-based liability derived from the common law.

Simply, courts are not required to ignore evidence of intent if there is such evidence, and there was plenty of evidence of what *Grokster* intended. As the Court noted, the unlawful objective is unmistakable. The Supreme Court injected into copyright law some common sense based on centuries of common law.

The Court was also careful to balance the interests of content innovators and technology innovators. By focusing on the behavior of *Grokster* and similar companies and not the technology they used, the Court separated the good actors from the bad and left intact the *Sony Betamax* standard that has served creators, technology developers and consumers so well.

The clarity provided by the Court, rather than stifle innovation, will increase it. Companies like iMesh, SNOCAP, Mashboxx, Pier Impact and P2P Revolution, as well as new technologies that operate within the law, will have a chance to gain traction, attract investors and appeal to fans.

Within days of the decision, venture capital firms were calling companies offering licensed P2P services, looking for opportunities to invest. The *Grokster* decision ensures the healthy growth of a legitimate market eagerly seeking support. Apple's iTunes, Real Networks' Rhapsody, Napster, Ruckus, Cdigix. Walmart, Yahoo and many others have worked hard to build successful destinations for legitimate online music.

The growing interest in these services can be clearly seen on the campuses of colleges and universities across the country. Nearly 70 schools now have deals with a legitimate service—a more than threefold increase from just last year. The decision in *Grokster* has played a major role in this growing trend, focusing attention on the issue of illegal file-sharing and providing school administrators with undeniable moral and legal clarity.

In fact, it has provided everyone with clarity. Those who make the movies, music, software and other creative content we love now know that their hard work will be protected. Consumers can now look forward to more of these great works and know that they can get them in a safe, secure, respectful and legal way. Those who seek to bring us content in fresh and innovative ways on new and old distribution platforms now know that they don't have to compete with illicit free-riders offering the same content for free.

Those who seek to support these exciting, new legitimate products and services can now have renewed faith in their investment. And those who have promoted the absurd notion that somehow it is OK to take someone else's property just because you can have been shown to be clearly wrong. And those who choose to continue their businesses with a model based on theft now know that there is no excuse. The time to go legit is now.

Thank you.

[The prepared statement of Mr. Sherman appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Mr. Sherman.

Our next witness is Mr. Gary Shapiro, President and CEO of the Consumer Electronics Association and Chairman of the Home Recording Rights Coalition. He led the manufacturers' legal and legislative battle to preserve the legality of the recording technology and consumer battle to protect fair use rights. He had been associ-

ated with the Squires Sanders law firm, a Phi Beta Kappa from the State University of New York and a law degree from Georgetown.

The floor is yours, Mr. Shapiro.

STATEMENT OF GARY J. SHAPIRO, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONSUMER ELECTRONICS ASSOCIATION, ARLINGTON, VIRGINIA

Mr. SHAPIRO. Thank you very much, Mr. Chairman, Senator Leahy, Senator Feinstein. The Consumer Electronics Association actually started in 1924 as the Radio Manufacturers Association, and now we have grown to some 2,000 companies, technology companies which employ hundreds of thousands of Americans, over $120 billion in sales, and are actually leading the economy and pulling it along through new technologies, many of which are giving different ways for the content community to reach their consumers.

I am also here as Chairman of the Home Recording Rights Coalition, which as formed in 1981, the day after the Ninth Circuit Court of Appeals ruled that motion picture companies had the right to keep VCRs off the marketplace, which you were referring to earlier.

While the Supreme Court in the *Betamax* case sparked a phenomenal technological renaissance of creativity and innovation that empowered consumers and created vast new markets for content providers, today in the post-*Grokster* world we are concerned that technological creativity and innovation may be stifled by the fear of future litigation and over-regulation.

The *Grokster* Supreme Court did not overturn *Betamax*, but created a new template, an inducement doctrine based on subjective intent. We are concerned about the future interpretation of this doctrine in the lower courts, especially in an environment where the media companies have expanding legal tools to limit the lawful activities of consumers, manufacturers and retailers.

Now, on any typical day the wired family sends news to friends over the Internet, rips songs from CDs to portable players, downloads information from the Web to be used in school and business reports, and copies information from home repair, cooking or shopping websites. Teenagers take images and sounds and text and weave them together in unpredictably creative and very innovative ways.

This use of technology to shift content in time, place, form and structure is redefining our culture and it is spurring new forms of creativity. Yet, all of these increasingly commonplace activities involve conduct that an overly broad interpretation of the *Grokster* case could prohibit.

We are at a crossroads today as we shift to a digital society. With new technologies allowing every citizen to be a creator, our national creativity can no longer be measured by CD sales. With photo, video and music studios shifting to the American home, with the Internet providing worldwide outlets for distribution, with new technologies leaping forward, now is not the time to chill American ingenuity. And yet *Grokster* has certainly created that chill.

Before developing a product in the post-*Grokster* environment, an innovator or entrepreneur will have to persuade everyone, from its

outsider bankers to its inside counsel, that the product can be sold without risk of a lawsuit. Venture capital migrates away from risky, litigation-prone areas. So the chilling effect of content industry lawsuits against entrepreneurs is not even an academic exercise at this point.

Consider the company Replay. That was a competitor to Tivo in the personal video recording market. It was driven to bankruptcy by litigation brought by MPAA members. Among the claims in the complaint they filed was that Replay, which is almost just like Tivo, induced the reproduction of copyright material.

Well, one of today's hottest new products brought by a tiny company is the sling box. It is an ingenious new product that lets you watch a television signal from your home, cable or satellite TV service on a laptop computer, no matter where you are. There is no infringement here. No copies are being made and you can only connect to one device at a time. Yet, according to published reports, the MPAA has already threatened the company with a lawsuit to stop the sale of the product.

Now, driving our concern as a technology industry is the fact that over the last decade, copyright law that this Congress and previous Congresses have passed has repeatedly been changed to strengthen the rights of copyright owners, while narrowing the rights of consumers and technology entrepreneurs. Terms of copyright are much longer. Penalties for infringement are much harsher. The DMCA made it illegal to create, or arguably even to discuss technologies which circumvent a copyright protection scheme.

Now, individually, each of these Acts passed by Congress seems justifiable. But, cumulatively, they have totally tilted the balance toward copyright owners and away from users and technology companies. These new powers, fortified by the *Grokster* decision, make it easier for content owners to bottleneck innovation to the narrow paths approved by copyright owners.

Indeed, just last week the motion picture industry announced that it is forming an exclusive consortium called MovieLabs to examine and license approved copy protection technologies. Centralizing licensing in a body owned and controlled solely by the movie industry is a powerful weapon in the wake of *Grokster*. Sheer market power of these six studios should be of interest to this Committee and to the Department of Justice.

Despite winning the *Grokster* case, the content community is seeking even more legislative tools. Right now, the recording industry is approaching another Senate Committee with a proposal to give the FCC broad power to impose design requirements on new digital radios. And unlike the TV broadcast flag, the RIAA is not aimed at mass, indiscriminate, anonymous distribution of content over the Internet. The RIAA digital radio proposal is aimed squarely at limiting non-commercial recording entirely by a consumer in a private home. It would work an enormous change to copyright law and fair use. Yet, this proposal has never even been put to this Committee or to Congress.

We do not believe that this is the time to hand new weapons to copyright proprietors to use against new technologies and inventors and entrepreneurs. But if the content community insists that they need further protections under the law, then we ask at a minimum

that a clear statement of manufacturer and consumer protections be part of the equation. That is why in the House we support H.R. 1201, which would provide a clear statement by codifying the *Betamax* doctrine.

Thank you.

[The prepared statement of Mr. Shapiro appears as a submission for the record.]

Chairman SPECTER. Thank you, Mr. Shapiro. We now turn to Professor Mark Lemley, Neukom Professor of Law at Stanford, and director of the Program at Stanford in Law, Science and Technology. He is the author of 6 books and 65 articles, has a law degree from Boalt Hall and a bachelor's degree from Stanford University. He is one of the top intellectual property lawyers in California.

Thank you for coming in today, Professor Lemley, and the floor is yours.

STATEMENT OF MARK A. LEMLEY, WILLIAM H. NEUKOM PROFESSOR OF LAW, STANFORD UNIVERSITY LAW SCHOOL, AND DIRECTOR, STANFORD PROGRAM IN LAW, SCIENCE AND TECHNOLOGY, STANFORD, CALIFORNIA

Mr. LEMLEY. Thank you, Mr. Chairman. I want to start by saying that I am encouraged at the title of this hearing, which is "Protecting Copyright and Innovation in a Post-*Grokster* World," because the message I want to bring to you is that both protecting copyright and protecting innovation are extraordinarily important. Copyright is good because it encourages creativity. Innovation is good because it encourages a variety of other activities, and indeed facilitates the use and distribution of copyrighted works. The important thing is not to promote one at the expense of the other, but instead to try to find a balance.

Now, the problem is that there are abuses. There are, as has been mentioned in this Committee already, undoubtedly abuses of copyright by high school and college students, as Senator Feinstein mentioned, who are downloading or uploading without authorization. That is illegal and it should be illegal. There are abuses by technology companies in rare cases such as Napster, designed solely to facilitate those acts of infringement.

But I want to make it clear that there are also abuses of copyright law by copyright owners who are asserting rights designed to go after the people who are infringing instead of against legitimate technology companies. This isn't a "may happen"; this is an "is happening." We have seen lawsuits filed by copyright owners against the makers of consumer electronics devices that play music, against the makers of consumer electronics devices that allow you to record off of the television, against Internet auction sites like eBay, against Internet service providers, against search engines like Google, against bookstores like Amazon.com, against the telephone companies who own the wires over which data is transmitted, against venture capitalists who fund companies which in turn support infringement, and even against the law firms who advise companies.

Now, this is a problem for the same reason that violation of copyright law is a problem. We have got to have a balance between

copyright law and innovation. *Grokster* tries to distinguish good from bad, tries to strike that balance by saying we are going to create a legal tool that goes only after the bad and not a legal tool that goes after the good.

Whether it succeeds or not, I think, remains to be seen. In my written testimony, I talk about some uncertainties relating to how the Court opinion will be interpreted. But because of those uncertainties, I think it may be premature to legislate to modify the opinion. Maybe Mr. Sherman is right and everything will be fine there.

That doesn't mean, however, that the problem is going to go away, either the problem of copyright infringement—as Senator Feinstein acknowledged, it is still with us in the digital environment—or the problem of threats to innovation. So what I want to suggest outside of *Grokster* are some things we might do, and also that we might not do, to address this problem.

What might we do? The first thing we ought to do, I think, is make it easier to target the people who are actually infringing, not perhaps in a criminal environment, although that is possible. We don't necessarily want to put college students in jail, though we have the legal tools now that would allow us to do that, and it would send a signal.

I have proposed, along with Professor Tony Reese, a way of using the Copyright Office and the copyright royalty judges that this body created last year to try to create a cheap, easy mechanism for findings of infringement against direct infringers in ways that would impose a civil sanction that would hopefully make it clear to those people that they are infringing and deter them from doing so, and I have attached that proposal to my testimony.

Second, I want to endorse Marybeth Peters's statement that we have got to make it easier to clear digital rights. The problem with legal music services is not just that you can't compete with free; it is that they have been so far unable to compete with ubiquity. People can get any song they want on an illegal service. They have not been so far able to get any song they want on a legal service, and that is because of the morass of rights that have to be cleared from multiple different owners in order to get rights in a digital environment. We have got to cut through that morass.

Third, and finally, what I want to suggest is some things that we ought not to do, and in particular that we ought not try to impose technology mandates on innovative companies. Technology is good. It can be used for bad purposes, but if we give control over the design of a technology to one individual, history has shown us time and time again we will get bad innovation.

Remember the pre-AT&T breakup phones. We got a lot of innovation in phone manufacturing once we let a whole bunch of people innovate in the phone industry. We didn't have innovation before that time. Innovation by committee, innovation only at the sufferance of all copyright owners collectively, would be even worse.

So what I want to suggest is that while this Committee should target acts of direct infringement, while the *Grokster* opinion does correctly target people who are engaged in acts of inducement, this Committee ought to be very careful to avoid targeting or giving copyright owners the tools to target legitimate technology compa-

nies, because those legitimate technology companies, as Mr. Shapiro suggested, are existing right now in a state of fear. They have been sued. They recognize that they will be sued again and we shouldn't make the problem worse for them.

[The prepared statement of Mr. Lemley appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Professor Lemley.

Our next witness is Mr. Ali Aydar, Chief Operating Officer for SNOCAP. Prior to joining SNOCAP, he was the Senior Director of Technology at the original Napster. He has a mathematics/computer degree with special concentration in technology-based entrepreneurship from Carnegie Mellon.

We appreciate your being here and look forward to your testimony.

STATEMENT OF ALI AYDAR, CHIEF OPERATING OFFICER, SNOCAP, INC., SAN FRANCISCO, CALIFORNIA

Mr. AYDAR. Thank you, Mr. Chairman, Senator Feinstein, for the opportunity to be here this morning. My name is Ali Aydar and I am Chief Operating Officer of SNOCAP, a San Francisco-based company working to create a digital music marketplace that meets the needs of copyright owners, online retailers and consumers.

SNOCAP's founder, Shawn Fanning, is very sorry that illness prevents him from being here this morning. Six years ago, I joined Shawn as the first employee of an unknown music file-sharing service called Napster. Napster unleashed an appetite for digital music that no one knew existed. When I joined Napster, there were 40,000 registered users. When it shut down, there were 85 million. At its peak, Napster users were launching hundreds of thousands of searches every second.

The day after the company shut down, Napster's founders got together. We understood the problems facing digital music and felt compelled to fix them. We envisioned a technology-based solution built upon what we learned from our experience. We had learned that consumers want to listen to everything, not just the record companies' active catalogs, but every song or symphony ever recorded.

We had learned that it was not just about free; it was about access, having whatever music you want whenever and wherever you want it. Fans want music and they are willing to pay for it. Artists and rights-holders want and deserve to be compensated. There has been progress in meeting these challenges. Roughly two million tracks are available for sale and rights-holders are being compensated.

Yet, still, consumers aren't getting the music they want. Authorized sellers offer far less than the over 25 million tracks that can be found on P2Ps. Because there are literally hundreds of thousands of copyright owners, in order to match the number of tracks that existing P2Ps provide, each online retailer would have to strike tens of thousands of deals—a legal, economic and practical impossibility.

Consequently, retailers focus on what is considered most popular, making it unlikely for consumers to find everything they want on existing authorized services, whether it is an up-and-coming local

band or a classic radio hit from their youth. But where some saw only a legal and practical mess, we saw a technological opportunity and a market-based solution. SNOCAP is our effort to provide that solution, a business-to-business service that benefits rights-holders, online retailers, including legitimate P2Ps that respect copyright, and consumers.

SNOCAP acts as a one-stop registry and clearinghouse. Copyright owners register their content with SNOCAP and set the price in terms of distribution. SNOCAP also helps content owners identify less well-known tracks that are being shared on P2Ps and allows them to register and set terms on which these tracks can be shared or block sharing altogether.

Retailers can access content through SNOCAP rather than negotiating hundreds or thousands of separate deals. It allows entrepreneurs to develop new business models and it gives thousands of online communities, whether they are maintained by non-profit organizations or giant corporations, the ability to form their own P2P networks and share content, while ensuring that rights-holders get paid. With SNOCAP, consumers legally get access to much more music and the benefits of file-sharing in an environment that works for everyone without the adware, spyware viruses and spoof files that plague the P2Ps today.

This vision has been embraced by the industry. Major labels and many independents are currently registering their content with SNOCAP and progress continues. We expect that consumers will be able to buy music online from a SNOCAP-enabled retailer by early next year. It will be a dramatic step forward and it is just the beginning.

SNOCAP has the potential to bring creators, retailers and consumers together as a registering and clearinghouse for every type of digital content, including film, television and books. As media and technology continue to mature, SNOCAP will enable rights-holders to efficiently move beyond the PC to new channels, allowing the Internet to finally realize its most fundamental promise—a medium where the world's information, knowledge, art and science can be shared universally, immediately and legally.

Thank you.

[The prepared statement of Mr. Aydar appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Mr. Aydar.

Our final witness is Mr. Sam Yagan, President of MetaMachine, and developer of the file-share application commonly known as e-Donkey. Prior to working there, he co-founded the educational publishing company SparkNotes, now known as Barnes and Noble. He has an applied math degree from Harvard and an MBA from Stanford.

The floor is yours, Mr. Yagan.

STATEMENT OF SAM YAGAN, PRESIDENT, METAMACHINE, INC., NEW YORK, NEW YORK

Mr. YAGAN. Thank you, Chairman Specter, Senator Feinstein. Thank you for inviting me to testify on this issue that will undoubtedly have broad and lasting ramifications for both the content and technology industries.

For the last 3 years, I have served as President of MetaMachine, the developer and distributor of the peer-to-peer file-sharing application e-Donkey. From my vantage point, I have witnessed and participated on the front lines of the confrontation between content and technology. I hope my experience on this cutting edge will be valuable to your Committee.

You might be curious to know what kind of person might run a peer-to-peer company, so I would like to tell you a little bit about myself. Prior to joining MetaMachine, I was co-founder and CEO of an educational publishing company called SparkNotes, which is now owned by Barnes and Noble. In that role, I was a rights-owner and my job was to sell books, not so different from the record label's job of selling CDs. I share this background with you to give you comfort that I am not an anarchist and I have no axe to grind with the owners of intellectual property.

Before I get to the core of my opening statement, I would like to make it clear to the Committee that we have replied to the RIAA cease and desist letter and I have personally committed to Mr. Sherman, which I reiterate today, that we are in the process of complying with their request.

Therefore, I am not here as an active participant in the future of P2P, but rather as one who has thrown in his towel, and I hope not to replay past issues today. I hope that as a result of my pending retirement from the P2P business, I can speak with more candor and that you will accept my testimony not as pushing any self-serving agenda, but merely as sharing with you my views on the post-*Grokster* world.

I would like to comment on three elements of the *Grokster* case. First, because the *Grokster* standards require divining a company's intent, the Court's decision was essentially a call to litigate. This is critical because most start-up companies just don't have very much money. Whereas I could have managed to pay for a summary judgment under *Betamax*, I simply couldn't afford the protracted litigation I needed to prove my case in court under *Grokster*. Without that financial ability, exiting the business was our only option, despite my confidence that we never induced infringement and that we would have prevailed under the *Grokster* standard.

Second, the Court specifically cites that Grokster's marketing to former Napster users indicated a principal, if not exclusive intent to bring about infringement. Is this really proof of intent to induce? Does that mean that every advertiser that is advertised in the e-Donkey software also have a similar intent to induce? I should hope not because last summer the campaigns of both President Bush and Senator Kerry ran advertisements on e-Donkey. Were they really both courting the swing infringement vote, or could they have had some other intent?

My final point on *Grokster* is that its inducement standard is not sustainable as a long-term equilibrium. Imagine if since e-Donkey's inception not only had we not made any statements inducing infringement, but that we had made no statements at all other than putting up a website that read "e-Donkey is a peer-to-peer file-sharing application." Those words alone seem that they would not qualify as affirmatively and actively inducing infringement.

If we had never made any other statements, would we be in the clear right now? If so, new peer-to-peer applications will inevitably spring up and easily satisfy *Grokster* in this way. If we would not be in the clear, then the effect of *Grokster* will go far beyond merely chilling innovation; it will almost certainly freeze it in its tracks.

I would like to wrap up by humbly stepping well beyond my area of expertise and making four observations that may be beneficial as you continue your oversight on this issue.

First, I hope you will encourage a market solution. I don't think anyone can predict how this will shake out, but I have limitless trust in our free market system to generate numerous new business models to take advantage of the tens of millions of Americans who use P2P. Imagine if we could monetize just 1 percent of the estimated tens of billions of shared files. There is a market solution to be found and it may well be one that fits into the business model of the incumbent entertainment industry, but it is not for us to decide. That is best left to the market.

Second, on this issue I hope you will be especially aware of unintended consequences. With many P2P applications offshore or simply open-sourced, the entities that will end up being most devastated by *Grokster* will be those like us that set up shop in the U.S., abided by American laws, paid taxes, and at least in our case tried to license content from the entertainment industry. I fear that the winners in *Grokster* will not be the labels and the studios, but rather the offshore, underground rogue P2P developers who will have just lost half a dozen of their most legitimate competitors.

Third, I hope you will consider the global context. As you know, e-Bay recently acquired the P2P company Skype for more than $2 billion. Skype was founded offshore, despite having American investors. It would be a real tragedy and a blow to our economy if our future technologists follow suit.

Finally, I have started a few companies in my career and if I have one overriding passion, it is for entrepreneurship, the driving force of our economy. I urge you to try to empathize with entrepreneurs trying to innovate in nascent industries. I hope you will do all that you can to nurture and encourage entrepreneurs, and provide them with a legal environment in which they can face the myriad challenges that startups do without the additional burden of having to wonder how a judge many years in the future will construe their every e-mail, every phone call, and indeed every thought.

I am happy to take any questions.

[The prepared statement of Mr. Yagan appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Mr. Yagan.

Mr. Roe, Mr. Sherman, what remedies do you think can be implemented to protect property rights short of criminal prosecutions? I will start with you, Mr. Sherman.

Mr. SHERMAN. At this point, we are not seeking any particular legislation with respect to the *Grokster* decision itself.

Chairman SPECTER. I am not talking about legislation. I am talking about enforcement. How do we implement enforcement to protect property rights?

Mr. SHERMAN. Well, there was some legislation pending in the last Congress that would have made it easier for the Department of Justice to enforce rights dealing with issues such as the number of files and the valuation of these kinds of files. That was not enacted, but that is the sort of thing that could be done that would make the job of the Department of Justice easier.

The idea of giving the Justice Department an opportunity to bring civil actions I always thought was a very good idea because it meant that the punishment could be commensurate with the violation, so that it wasn't a question of criminal prosecutions. Half or more of the lawyers in the Justice Department are on the civil side rather than on the criminal side, so it would mean that a lot more attorneys would be available to do something helpful on economic crimes.

Chairman SPECTER. There is limited time, so let me move to Professor Lemley. Professor, you say that we ought not to stifle legitimate technology. And, Mr. Shapiro, you are worrying about chilling innovation.

I will start with you, Professor. How do you identify the legitimate technologies and see to it that they are not harassed, while still protecting property interests?

Mr. LEMLEY. Thank you, Mr. Chairman. Well, as Mr. Yagan indicated, the intent standard is a difficult one to meet. So I think the answer is a difficult one to understand; it is a difficult one to know whether you comply with it. So I think the answer has to have two parts. One is I would like to see both private and governmental enforcement focus its attention more closely on the people who are actually doing the infringing rather than companies that provide software or services that can be used to facilitate infringement. Targeting direct infringers, I think, is helpful because there we are not concerned about the impact on technology.

The second thing that I think you can do is to have legal standards that are as clear as they can be and are as narrowly circumscribed as they can possibly be to target only people in the secondary liability space that really are bad actors. That is hard to do, and I worry a little bit about how the *Grokster* opinion will be interpreted in the lower courts, but for now it might prove to be a workable standard.

Chairman SPECTER. Mr. Shapiro, you articulate very important principles not to stifle technology or chill innovation. How do you accomplish that and still protect the property interests that Mr. Roe and Mr. Sherman are so concerned about?

Mr. SHAPIRO. Mr. Chairman, I think you make it clear that there is a balance. Right now, I think I am with most of the other panelists and the prior ones that I would not encourage Congress to do much of anything. I think this case has to be sorted out a little bit. It set a very high bar. We are very concerned about the intent standard because—

Chairman SPECTER. Congress should not do much of anything?

Mr. SHAPIRO. On this specific issue right now.

Chairman SPECTER. We are good at that.

[Laughter.]

Chairman SPECTER. Go ahead.

Mr. SHAPIRO. But if Congress is to act in the copyright arena, I would have to say it has to also focus on what rights consumers have, not just the copyright owners. I would also redefine the Copyright Office, frankly, so it is just not protecting copyright owners.

I am concerned about making the U.S. Government the law firm for the RIAA and the MPAA. I don't think that is appropriate, which some of the proposals have done. I think the term of copyright should be reduced. Actually, Congress did make a decision which helped the Supreme Court. Congress acted to make it clear that downloading in the home is an illegal activity, and because of that, the Supreme Court say that that is an illegal activity. Therefore, it is inducing this illegal activity. Also, the RIAA has sued some 10,000 Americans, some 10,000 teenagers, collected about $30 million to finance the RIAA, according to published reports. So what you have is—

Chairman SPECTER. My time is almost up, but I want to—

Mr. SHAPIRO. I am sorry. You have done a lot already is what I am saying.

Chairman SPECTER. I want to move to Mr. Yagan. You heard Mr. Aydar's suggestion to bring all of these competing forces together. Do you think it is a good idea?

Mr. YAGAN. Mr. Chairman, I think my primary interest is in promoting as many different marketplace solutions as possible. So I am very excited about what SNOCAP is trying to do. I have been meeting with Mr. Aydar for well over a year on this topic. So I think it is a good idea, but I think we have to be very concerned not only about what we are doing internally, but how is the technology going to develop in an offshore environment.

I believe that the result of the *Grokster* case will be that all of the existing peer-to-peer applications will be converted or in some other way will cease operations, but that does not mean that the file-sharing itself will necessarily stop. So I think as we think about what the market solution is or what the legislative solution is, we have to keep in mind the practical consequence that just because companies like mine may no longer exist, the technology still will.

Chairman SPECTER. Thank you, Mr. Yagan. The red light went on during your answer, so I yield now to the new Ranking Member, Senator Feinstein.

Mr. SHERMAN. Mr. Chairman, if I may just interject one thing, I just want to correct the record. There is no truth to the notion that the RIAA has collected anywhere near the amount of money Mr. Shapiro thinks. I just want to make that clear.

Chairman SPECTER. Senator Feinstein.

Senator FEINSTEIN. I have listened to this with great interest and the position I am having the hardest time understanding is yours, Mr. Shapiro.

Mr. SHAPIRO. I suspected that.

Senator FEINSTEIN. Yes, because you represent patent industries that want to protect their patents. In my book, there is no difference between the patent and the copyright. They are both protective mechanisms for people who have created to be able to recover based on the creation. So in my view, what is sauce for the goose is sauce for the gander. So should we reduce patent?

Mr. SHAPIRO. I would be very comfortable reducing copyright to the term of a patent, but now it is about five times the term of a patent. It used to be very close together, and Congress repeatedly expanded it at the request of copyright owners. It now is so ridiculously long that there is very little in the public domain that can be used in these new systems.

Senator FEINSTEIN. But you certainly don't want less patentability for the companies you represent.

Mr. SHAPIRO. Well, we do represent most of the patent owners in the non-medical area, and there is no question about that. The patent law does have some challenges as well, but the difference in a patented product, a physical product, and a copyrighted product is that if I take your patented product from you, you no longer have that product. If I use your copyrighted product, you have not actually lost something physical. In fact, you may have gained something and I may want to buy more of your product.

Senator FEINSTEIN. You lose your income.

Mr. SHAPIRO. You lose a potential source of a sale. Every one of these estimates of lost sales actually may be an estimate of what was taken, but not paid for. A lot of these people would never pay for that, but there is some gain. They do get exposed to artists, they learn about artists. It is not all bad. It is arguable whether it is bad or good.

It clearly is wrong. I would agree that P2P—I do not represent P2P companies. P2P is wrong. I am concerned about the broader context of that ruling in how all new technology is introduced because so much of new technology is shifting content around in time and space and managing it.

Senator FEINSTEIN. Thank you. I was very interested in what Mr. Aydar said about SNOCAP. Now, that seems to me to be a very good model.

Do you agree, Mr. Sherman?

Mr. SHERMAN. Absolutely. The record companies and the rest of the music community are very excited about the offering. It is an entire system that can make P2P legal. It would allow non-infringing uses of it to continue, but it would enable you to identify infringing transmissions and turn them into legitimate sales with a back office function that provides royalty payments to everybody. That is a beautiful model.

Senator FEINSTEIN. Well, then, Mr. Yagan, why wouldn't we want to see the SNOCAP model become the state-of-the-art for the entire industry? It seems to me to be a fair outcome whereby everybody gets basically what they need to survive.

Mr. YAGAN. I support that fully and I wish SNOCAP the best of luck, and we are in the process from an e-Donkey perspective of determining what our technological solution will be as we strive to convert the existing traffic we have into traffic that will be in one of these closed environments.

At the end of the day, as much as I think it is a good idea and everyone else on this panel may think it is a good idea, it is at the end of the day up to the consumers, the 60, 70, 80 million consumers in America who are downplaying music on these P2P applications, whether they are going to leave the existing open environ-

ments and move over to a closed SNOCAP-type environment. I have no idea if that is going to take place in the market.

Senator FEINSTEIN. I would just note that the solution comes from San Francisco.

[Laughter.]

Senator FEINSTEIN. Let me ask all of you, assuming that models like SNOCAP are the solution, what do we do to promote that solution? What is clear to me after so many years is just staying out of it and letting the two sides go at each other isn't going to solve it, and the only thing that is going to happen is there is going to be a lot of litigation. So how would you suggest that the Congress or someone would proceed if, in fact, the SNOCAP model is a good solution?

Mr. LEMLEY. Well, let me start off, Senator Feinstein, by suggesting that part of the difficulty that all of the peer-to-peer file-sharing services have had in negotiating for rights—and I think they have all tried to do so—is there are so many different rights-holders, not only because there are lots of different songwriters and there are lots of different recording companies and movie companies and they have each got rights, but because the rights have been divided according to a pre-digital world, so that one group of companies ends up with the rights to own publishing music and another group owns the rights to public performances of music And, of course, a digital broadcast is both.

So we need some way, whether it is in Section 115 or some other way, to consolidate those interests so that there are a relatively small number of people who can sit down at the table and negotiate.

Mr. SHERMAN. I would echo Professor Lemley's remarks. Licensing reform in Section 115 would help especially the new business models where there are uncertainties about how the law applies. We don't have dispute resolution mechanisms in place to solve those problems and get new, innovative ideas to market quickly.

Senator FEINSTEIN. So let me ask this question. Is everybody agreed, then, that a solution lies within 115?

Mr. SHERMAN. I certainly feel that way.

Senator FEINSTEIN. Any dissenters? Oh, I knew it.

Mr. SHAPIRO. Well, I just can't say I agree with that, but what I would say is that part of the problem is the difficulty locating copyright owners. That is the biggest part of the problem, and part of it is because the copyright term is so gosh-darn long now. It is just impossible to use old stuff anymore.

If there was a way of identifying copyright owners—and there have been proposals where you have to register with a dollar every 20 years or whatever it is just to say you are still alive. There are some proposals out there which are very reasonable and would allow a more central way of finding out who owns what. But a DVD shouldn't cost the same price as a CD. The motion picture industry has done it right. The music industry has done it wrong, plus they have been saddled by all these different rights and who owns what.

Mr. SHERMAN. The Section 115 reform that is being talked about would create a blanket license system so that a filing of a single

paper would cover all of the copyright owners identified or unidentified, which would address Mr. Shapiro's problem.

Mr. ROE. If I could say one thing, just in the past 2 years just the education of informing people of what they were doing was illegal has actually deterred illegal downloading almost by 50 percent. So it has had some effect, the education, but I do have a little bit of issue with the fact that Congress shouldn't do anything at this moment.

I think in the early stages of any technology, whether it be the automobile or the recording business in general, there are times where we have to set the boundaries of how is this new technology going to be handled. And I hope that the information you have gathered here today will help you all do what you are supposed to do here.

Chairman SPECTER. Thank you, Mr. Roe.

Senator FEINSTEIN. Thank you. My time is expired.

Chairman SPECTER. Mr. Aydar, you haven't had a chance to comment. We would be pleased to hear from you, although SNOCAP has received lofty praise here.

Mr. AYDAR. Well, in terms of legislation and whether Congress should do anything, SNOCAP is out there promoting a technology and a market-based solution. We believe that it would be helpful to see where that market-based solution leads us. We feel that we have built a solution that works within the copyright law and will make the number of works that are available on a legitimate service comparable to what is available on a peer-to-peer network, thereby making those services able to compete, thereby making those services compelling and capturing the users that are using these P2Ps today.

Chairman SPECTER. Well, thank you all very much for coming in. I regret we do not have more members. You have come on a very, very busy day. We are on the floor with the Roberts nomination, which is occupying a great deal of attention. We had scheduled at the same time a conference on what to do about hurricane costs and offsets. So it is a very busy season.

But there is a great deal of concern for both sides of this issue to promote artistic accomplishment and innovation on technology. The Internet has been magnificent, the artistic works have been magnificent, and these are issues of great importance on both sides to America and to the world. So we will continue to study them, and at least in the short term I think we will carry out the wishes of those who would like to see us do nothing, at which we are very good, until Senator Feinstein tells us precisely what to do.

[Laughter.]

Chairman SPECTER. Thank you all very much.

[Whereupon, at 11:14 a.m., the Committee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

Questions for the Ali Aydar, Chief Operating Officer, SNOCAP
October 5, 2005
"Protecting Copyright and Innovation in a Post-Grokster World"

1. Your testimony indicates that the SNOCAP service requires registration from copyright holders. How many rights holders have registered their works with SNOCAP and do you currently have the cooperation of the content industry?

SNOCAP provides digital music and technology services to Universal Music Group, Warner Music Group, SONY BMG MUSIC ENTERTAINMENT, EMI, The Orchard, CD Baby, TVT Records, Artemis Records/Sheridan Square Entertainment, Beggars Group, Koch Records, Nettwerk Records, Matador Records, One Little Indian Records, Ryko Group and an extensive roster of other leading independent labels. SNOCAP's registry currently contains over 3 million tracks from 3,000 record labels and is growing daily..

2. I'm advised that users commonly complain about the viruses, spyware and pornography sometimes associated with peer to peer networks. Does SNOCAP do anything to filter out *these* undesirable files for users who choose to use your service?

SNOCAP's registry is designed to identify content ownership and does not filter out viruses, spyware and pornography. Peer to peer networks claim they cannot filter such content on their own, but they can. The reason why they don't is that if they were to filter out viruses and spyware, for example, they would be acknowledging that their systems can also be configured to filter content based on the rights ownership using a registry like SNOCAP's, which they continue to claim they cannot do.

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Protecting Copyright and Innovation in a Post-Grokster World
Responses to Senators' Follow-Up Questions
Professor Mark A. Lemley

Senator Specter's Questions

1. *Your written testimony suggests that Congress should take steps in making it easier for copyright owners to target direct infringers through the use of the Copyright Royalty Judges system. Can you elaborate further on this point?*

I believe that Copyright Royalty Judges could administer a quick and inexpensive system of administrative adjudication against individual file-sharers. Such a system would be cheaper, faster, and easier for both copyright owners and accused infringers to use. I have elaborated on this idea in more detail, including draft statutory language, in my article with R. Anthony Reese entitled *A Quick and Inexpensive System for Resolving Peer-to-Peer Copyright Disputes*, published in 23 **Cardozo Arts & Entertainment L.J.** 1 (2005). A copy of that paper is attached.

2. *Your written testimony recommends limiting the availability of statutory damages for those persons held liable under a theory of secondary liability. Is it your position that such damages remain unavailable even for those secondary infringers who actively induce copyright infringement?*

Yes. Statutory damages are designed to ensure that copyright owners are compensated for infringement of low-value works. Their use makes the most sense in cases of direct infringement where relatively few works are at issue. It makes less sense in the peer-to-peer environment, where many thousands of copyrighted works (and therefore millions or potentially even billions of dollars in statutory damages) are at issue. And applying statutory damages makes no sense at all when the defendant is not itself the infringer but merely a technology company accused of aiding infringement. First, statutory damages are already available against the direct infringers in such a case, making their availability against indirect infringers redundant. Second, the reason copyright owners are suing those indirect infringers is precisely so that they can aggregate liability in one company rather than pursuing many thousands of individual direct infringers. Since liability is aggregated in this way, normal copyright damages should suffice to compensate copyright owners for any lost profits in an indirect infringement case.

3. *In your testimony before the Senate Judiciary Committee, you stated that the government should focus on the direct infringers of copyright because the intent standard for secondary liability was difficult to meet for manufacturers and distributors of emerging technologies. In light of this testimony, how might Congress clarify the intent standard to ensure the fostering of emerging technologies while protecting the rights of copyright holders?*

Defining a corporation's intent is a difficult, perhaps even intractable problem. I believe the courts – and if necessary Congress – should interpret the Supreme Court's *Grokster* decision

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narrowly in order to avoid opening legitimate technology companies to liability. The Court's opinion can be read as suggesting that a company induces infringement if its customer support employees answer technical questions from users who they should know or infringing. It can also be read as suggesting that a company induces infringement unless it redesigns its product to minimize the risk of infringement. Both of these results, if adopted by the lower courts, could significantly chill legitimate business activity.

This is not the only way to read the *Grokster* opinion, however. The Court expressed sensitivity to the risk of stifling innovation. In my view, proof of inducement after *Grokster* requires evidence of conduct that facilitated infringement by others, coupled with evidence that the defendant's business model was directed towards promoting infringement, not merely that some employees in the company may have facilitated individual acts of infringement.

Senator Leahy's Questions

1. *We have heard a lot about filtering, especially since the Grokster decision was announced. When we say "filtering", we mean having a technology that can distinguish between digital files that copyright holders are willing to share, and those that they are not. Has anyone accomplished such filtering on a scale that would meet the demands of consumers? Is the available technology keeping pace with the demands of the law?*

I do not believe that any company today can filter infringing content from legitimate content with complete effectiveness. Nor am I confident that anyone will be able to do so in the foreseeable future. Part of the problem stems from the sheer number of copyrighted works that would have to be identified, and the lack of a comprehensive registry of such works in the Copyright Office or elsewhere. A further problem is distinguishing between copyrighted works whose owners are willing to permit copying and those whose owners object to copying. But an even greater problem is that no filtering system can replicate the complex contours of copyright law. Copying some portions of a work is permissible for some purposes under doctrines like fair use and de minimus infringement. Further, some uses of a work are exempt from liability under a series of defenses, or permissible upon the payment of a compulsory license. Technological filtering systems do not capture this complexity, instead tending towards and "up-or-down" decision to permit all uses of a work or permit none.

None of this means that content filtering is a bad idea. It has promise in identifying and technologically blocking obvious cases of infringement. But it does mean that the law should not require perfect filtering as a condition of the operation of a peer-to-peer network or any other program or device. Because perfect filtering can never be achieved, requiring it is equivalent to banning a technology altogether.

2. *Many people treat the Grokster decision as if it ended the story on liability for inducing the infringement of copyright. The Supreme Court did write a strong opinion on the subject, but that case is back in the trial court, and there will doubtless be other cases brought. How do you see inducement liability developing in the trial courts, and what do you think the practical impact will be on consumers?*

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The *Grokster* opinion leaves open at least as many questions as it answers. Which of the many factors the court identifies in the case are actually necessary to prove intent? All of them? Could a new entrant into the file-sharing marketplace offering the very same functionality as Grokster or Streamcast shield itself from liability by avoiding statements encouraging infringement? Even if intent is proven, what conduct beyond merely selling a device with substantial noninfringing uses is required for liability? The courts will have to confront these issues.

The most important of these issues is intent. Defining a corporation's intent is a difficult, perhaps even intractable problem. I believe the courts – and if necessary Congress – should interpret the Supreme Court's *Grokster* decision narrowly in order to avoid opening legitimate technology companies to liability. The Court's opinion can be read as suggesting that a company induces infringement if its customer support employees answer technical questions from users who they should know or infringing. It can also be read as suggesting that a company induces infringement unless it redesigns its product to minimize the risk of infringement. Both of these results, if adopted by the lower courts, could significantly chill legitimate business activity.

This is not the only way to read the *Grokster* opinion, however. The Court expressed sensitivity to the risk of stifling innovation. In my view, proof of inducement after *Grokster* requires evidence of conduct that facilitated infringement by others, coupled with evidence that the defendant's business model was directed towards promoting infringement, not merely that some employees in the company may have facilitated individual acts of infringement.

Courts will also have to look at the question of what conduct is required to show inducement. If merely selling a product with substantial noninfringing uses becomes illegal when done with bad intent, the inducement standard will swallow contributory infringement liability and put all sorts of legitimate technology companies at risk of lawsuits probing for evidence of their intent.

How the new inducement test affects consumers will depend on how the courts answer these questions. A focused, narrowly tailored inducement test will allow the courts to target companies designed to promote infringement without putting other technologies at risk. But a more aggressive reading of the Court's opinion could subject Internet service providers, software and hardware makers to suit, and thus chill the innovative products on which consumers depend.

Senator Kennedy's Question

In Sony Corp. of America v. Universal City Studios, Inc., 464 U.S. 417 (1984), the Supreme Court articulated a 'safe-harbor' for those who invest in multiple-use technology. The Court held that there is no indirect liability for copyright infringement where there is "substantial non-infringing use," Id. At 442, Contributory infringement required actual knowledge of specific instances of infringement. In the Grokster case, the Court left the safe-harbor rush in place but held that where there is intent to facilitate or induce infringement then indirect liability will apply, even if there is no knowledge of actual instances.

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Grokster affirms that our concern as a society is with the use and abuse of technology, not with the technology itself. A photocopy machine in an office will make work easier and promote efficiency, but a photocopy machine in a bookstore may facilitate or induce copyright infringement.

This concern is whether an "intent to facilitate" charge can too easily be raised against inventors of innovative technologies or investors in them. If so, the result could be a chilling-effect on the technology industries we need to encourage.

Content providers are casting a wider net today in seeking to hold such investors liable. See, e.g., In re Napster, Inc. Copyright Litigation, 354 F.Supp.2d 1113 (N.D. Cal. 2005); UMG Recordings, Inc. v. Bertelsmann AG, 222 F.R.D. 408 (N.D. Cal. 2004). If investment occurs with the specific intent to benefit from the development of infringing applications, then such a case might have merit. But even where intent is absent, investors will still be forced to defend difficult and expensive law suits.

In your view, how should the standard for such liability be clarified?

In my view copyright liability properly extends to those who induce or contribute to acts of direct infringement, but it should stop there. The plaintiffs in the *Napster* and *UMG v. Bertelsmann* are asserting a theory one might call not secondary but tertiary liability – that venture capitalists and others should be liable for "helping the helpers." This theory, if adopted, would be a dangerous and unprecedented expansion of copyright liability, one that has no obvious limit. Copyright owners could sue the lawyers for a peer-to-peer company, the people who rented them space, the companies who provide them with computers or phone service, and anyone else with any connection to a company who turns out to help others to infringe. Courts have not and should not countenance such an expansion of copyright law. The further removed someone is in the chain from the direct infringer, the less reason there is for copyright owners to need to pursue remedies against that individual. Given the creation of inducement liability in *Grokster*, copyright owners have ample remedies against people who are actually found to be supporting or encouraging direct infringement, without having to cast their net so wide.

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The Register of Copyrights of the United States of America
United States Copyright Office · 101 Independence Avenue SE · Washington, DC 20559-6000 · (202) 707-8350

October 31, 2005

Dear Chairman Specter:

Thank you once again for the opportunity to testify before the Senate Committee on the Judiciary regarding "Protecting Copyright and Innovation in a Post-*Grokster* World." To complete the hearing record, I am also pleased to respond to the questions from Committee members that accompanied your letter dated October 7. My responses are attached.

Should you or the Committee have any further questions, or if I can be of other assistance, please do not hesitate to contact me.

Sincerely,

Marybeth Peters

Marybeth Peters
Register of Copyrights

cc: Senator Patrick Leahy

The Honorable Arlen Specter
Chairman, Committee on the Judiciary
United States Senate
224 Dirksen Senate Office Building
Washington, D.C. 20510-6275

Responses of Maryeth Peters, Register of Copyrights,
to Written Questions from the Senate Judiciary Committee
Regarding "Protecting Copyright and Innovation in a Post-*Grokster* World"

October 31, 2005

Question from Chairman Specter

During the hearing, the Honorable Debra Wong Yang, U.S. Attorney for the Central District of California, indicated that the Department of Justice needed additional resources to efficiently address intellectual property violations. Although I have asked her to submit additional information pertaining to these statements, I would also appreciate any further insight you may provide in this area. Specifically, could you please provide the Judiciary Committee with your recommendations on the following matters: the additional resources needed by law enforcement to combat intellectual property violations; how Congress may provide law enforcement with such additional resources; and, what legislation, if any, is necessary to ensure the proper enforcement of current intellectual property laws.

Response:

I would first like to stress how pleased I am with the measures Congress has already taken, particularly in the past few years, to ensure the proper enforcement of the copyright laws. Congress has broadened the scope of and increased the penalties for illicit conduct and has also provided new avenues of redress in both the civil and criminal contexts. For example:

- The Digital Millennium Copyright Act of 1998 ("DMCA") created a new Chapter 12 of the Copyright Act which prohibits the circumvention of, or providing devices that will circumvent, copyright technological protection measures, subject to certain warranted exceptions. Pub. L. No. 105-304, 112 Stat. 2860 (1998). Chapter 12 provides both civil and criminal penalties for violations of its provisions. The DMCA also added Section 512 to the Copyright Act, which provides incentives for Internet Service Providers ("ISPs") to take appropriate action to identify infringers and deny access to infringing matter. *See* 17 U.S.C. § 512(h).

- In 1997, the No Electronic Theft Act ("Net Act") amended both the Copyright Act and Title 18 to provide greater copyright protection by prohibiting willful piracy that may cause serious commercial harm despite the infringer's lack of a profit motive. Specifically, it defined "financial gain" to include "anything of value, including the receipt of other copyrighted works," characterized activity that has a substantial commercial effect even in the absence of a commercial motive as criminal infringement, increased the statute of limitations, established significant penalties for certain criminal infringement, permitted victims to file pre-sentence impact statements and directed the

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United States Sentencing Commission to ensure that the applicable guideline range for a defendant convicted of a crime against intellectual property is sufficiently stringent to deter such a crime. Pub. L. No. 105-147, 111 Stat. 2680 (1997).

- In 1999, the Digital Theft Deterrence and Copyright Damages Improvement Act enhanced the statutory penalties for copyright infringement by fifty percent. Pub. L. No. 106-160, 113 Stat. 1774 (1999).

- The Intellectual Property Protection and Courts Amendment Act of 2004 amended Title 18 to provide specific criminal and civil causes of action for trafficking in counterfeit labels, illicit labels, or counterfeit documentation or packaging. It also amended Title 17 to create a rebuttable presumption that online infringement was willfully committed if the infringer provided materially false contact information to the domain name registration authority with respect to a domain name used in connection with the infringement. Pub. L. No. 108- 482, 118 Stat. 3912 (2004).

- Last year, the Family Entertainment and Copyright Act of 2005 ("FECA") provided specific criminal causes of action for the unauthorized recording of a motion picture in a movie theater as well as for the infringement of works being prepared for commercial distribution (a.k.a. pre-release works). Pub. L No. 109-9, 119 Stat. 218 (2005). Pursuant to FECA, the Copyright Office has engaged in a rulemaking proceeding regarding the preregistration of pre-release works, and will implement the preregistration process next month.

- In part in response to FECA, the Sentencing Commission has just this month approved emergency amendments to the Federal sentencing guidelines setting stricter sentences for piracy and broadening the scope of punishable activity. Among other things, the amendments increased the penalties for infringement of pre-release commercial works and clarified these works' "retail value," and they defined "uploading" to include making a copyrighted work available by storing it in an openly shared file with the intent that others will download, access or copy the work. *See,* Sentencing Guidelines for United States Courts, 70 Fed. Reg. 61489-90, *available at* http://www.ussc.gov/FEDREG/fedr1005.htm (Oct. 19, 2005).

Measures such as these, in conjunction with the Copyright Act's general civil and criminal causes of action and the criminal code's prohibition on aiding, abetting or inducing the commission of a crime, 17 U.S.C. §§ 504, 506 and 18 U.S.C. §§ 2, 2319, have helped to strengthen the copyright law and appear at this time to be meeting the needs of copyright owners. Therefore, at this time I do not have any recommendations for additional legislation to ensure the proper enforcement of current intellectual property laws.

Moreover, because the Copyright Office has no direct involvement in, responsibility for, or authority over the actual enforcement of the copyright laws, I am not in the best position to evaluate what additional resources the law enforcement community may need to combat

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intellectual property violations. I have no doubt that it would be very desirable to provide increased funding to the Department of Justice and other federal law enforcement agencies to combat violations of copyright and other intellectual property rights. And Congress might be well-advised to take action to ensure that those funds are targeted to ensure that resources are allocated in a way that will result in effective enforcement of intellectual property rights wherever they are violated.

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Questions from Senator Leahy

1. In your written testimony, you described the Grokster decision as one step toward a healthy, legitimate on-line music marketplace. But you also urged the Committee to revisit the way in which music is licensed on-line. I know that you have testified before us on this topic, and I appreciate your input again. My understanding is that the various parties in the music industry have been negotiating among themselves. Have you taken part in those discussions? How do you think that these music licensing laws – which we all refer to as Section 115 – should be revised? What do you think will happen if we do not legislate a change in those laws?

Let me begin my recapping my involvement in discussions concerning the revision of Section 115. As you may know, in the summer of 2004 at the request of Representatives Sensenbrenner, Conyers, Smith and Berman, I hosted a series of discussions between the National Music Publishers' Association, Inc. ("NMPA") and its subsidiary The Harry Fox Agency, Inc. ("HFA"), the Digital Media Association ("DiMA"), and the Recording Industry Association of America, Inc. ("RIAA") relating to possible legislative reform of the music licensing provisions in Section 115. The parties met on several occasions with me and my staff throughout that summer and engaged in good faith negotiations, in addition to holding discussions among themselves. Eventually, the parties expressed a willingness to explore legislation to adopt a blanket licensing scheme which would utilize a single entity to collect and distribute the license fees. However, they were unable to reach a global consensus agreement on how to reform Section 115 because of disparate viewpoints on a number of substantive issues, including issues such as whether the Section 115 license should cover reproductions made in the course of "streaming" of music, how royalties should be determined, whether controlled composition clauses should be nullified, and other issues. Nevertheless, the parties agreed to continue negotiations on their own in hopes of arriving at a mutually agreeable solution but, as you know, those negotiations have broken down. Neither my staff nor I have not been involved in these subsequent discussions.

Earlier this year, the music publishers, record companies and digital music services were joined by performing rights societies such as ASCAP, BMI and SESAC as well as representatives of songwriters in more wide-ranging discussions of music licensing reform at the suggestion of the House Judiciary Committee. Those discussions expanded to include issues such as "hybrid" services that arguably involve both reproductions and public performances, for which composers and music publishers have traditionally engaged different sets of licensing agents. I was not directly involved in most of those discussions, although the parties informed me of the progress of the discussions. Despite lengthy discussions and two hearings in the House Subcommittee on Courts, the Internet and Intellectual Property and one hearing in the Senate Subcommittee on Intellectual Property, ultimately little progress appears to have been made in those discussions.

How do I think Section 115 should be revised? In light of the fact that the interested

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parties have been unable to resolve any of the outstanding issues as part of a comprehensive plan, I believe it may be prudent to consider approaching the revision of Section 115 in two steps. First, efforts should be made to streamline the compulsory licensing process under Section 115 to make it easier for online music services to clear the reproduction and distribution rights to musical works. More difficult issues, such as whether certain types of downloads are not only reproductions but also public performances, or whether certain transmissions of performances also require compensation for the exercise of the reproduction right, should be deferred to a later time.

One approach for addressing the administrative problems connected with the compulsory license is to create within Section 115 a Section 114-style blanket license, to be administered by a single agent, for the reproduction and distribution of musical works in a digital environment. The notice and reporting requirements under the license would be simplified to require, for example, submission of a single notice of intent to use the statutory license. Such a structure offers real advantages to the licensees and to the copyright owners. On the one hand, licensees would get "one-stop shopping" and simplified procedures for obtaining and using the license. On the other hand, copyright owners would benefit from the administrative oversight of a single agent that could monitor the use of their works under the license, and more effectively collect royalties from many sources and distribute them directly to each copyright owner. While not a perfect solution to the myriad of administrative problems identified by the interested parties, these basic changes would remove the main barriers that impede online music services from using the current Section 115 license today, and make the system workable on an administrative level. Moreover, it would be reasonably easy to adopt the Section 114-style blanket license and implement it in a relatively short time period, and it is a solution that the interested parties seem willing to accept.

However, it is not the only option. Other approaches could be employed for the administration of a blanket license and I have discussed these options in my prior testimony. For example, Congress could choose to repeal the Section 115 license and encourage a collective licensing structure, or to sunset the digital portions of the Section 115 license at some future time and allow the parties to work out a true marketplace solution. While I have always supported such solutions, the affected parties have shown no interest in exploring these alternatives.

However, they do have a keen interest in amending Section 115 to address a variety of substantive issues, ranging from a redefinition of the scope of the license to revising the provisions governing the adoption of the royalty payments to include expressly a percentage of revenues option. Resolution of these topics has proven elusive and divisive mainly because a final solution will require striking a balance between the needs and desires of the affected parties, and those parties have very different views on where that balance should be struck. The question of the scope of performance rights and the scope of reproduction rights is a particularly thorny question and its resolution will have an impact on how the other substantive issues are resolved. While there are a number of possible solutions to these problems, it would probably be

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counterproductive for me to recommend any particular solution at this time.

In any event, it is clear that the current Section 115 license is not a workable option for digital music services and that the law needs revision. Legitimate digital music services need an efficient and rapid means to license music in order to compete effectively with piracy. Failure to provide an efficient mechanism for clearing copyrights will only impede the growth of a wealth-producing industry that benefits the services, the songwriters and the public. It will also squander the opportunity that the *Grokster* decision has presented to the music industry. While *Grokster* struck a blow against illegitimate peer-to-peer services, that victory is likely to be temporary unless legitimate services are given the ability to give consumers what they want: the ability to obtain lawful access to any music the consumer wants, at reasonable prices and with the blessing of the copyright owner. Under a workable licensing regime, the digital music industry will continue to expand and make it possible for services to offer consumers a wider range of music at a reasonable price. Such legitimate use of music will benefit songwriters as well if they, through the legitimate use of their music, receive larger royalty payments.

2. At the hearing, many of our witnesses spoke about the national impacts of the Grokster decision. The Internet and p2p networking have made the world smaller – connecting millions around the world with each other in ways that were unimaginable twenty years ago. This opens up a host of awesome opportunities, but as Grokster illustrated, these opportunities can be misused. You mentioned, in your testimony, the difficulties in combating online piracy internationally. What hurdles are legitimate, domestic p2p network providers facing as they compete with providers who follow less stringent international policies to protect against piracy, and what can we do to most efficiently alleviate these roadblocks?

It is simply too early to assess *Grokster*'s effects on the international community. The *Grokster* decision is only four months old. This is a relatively short period of time to get a clear picture of whether or how many other countries will adopt its reasoning. Nevertheless, I am encouraged by some recent developments.

Other countries appear to be following our lead, including some jurisdictions which in the past have presented particular challenges to copyright enforcement. Since the Supreme Court's Grokster ruling, courts in Australia, Taiwan, Korea and China have ruled against peer-to peer file sharing services. While the courts in these and other countries are not necessarily adopting the *Grokster* inducement doctrine but in some cases are finding other ways to hold peer-to-peer services accountable for the infringements they faciliate, and while it is not clear whether these developments have been in response to *Grokster* or have simply been coincidental developments of other countries' own law simply because it is good policy and the time is ripe, the *Grokster* decision is important in the international context because it provides U.S. representatives with the credibility to encourage other countries to crack down on illegal peer-to-

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peer file sharing.

Of course, now that we have made it clear that our law prohibits the inducement of copyright infringement, it is conceivable that illegitimate peer-to-peer services will simply move offshore and outside of our jurisdiction rather than closing down, thereby forcing legitimate domestic services to continue to compete with the pirates. In fact, Kazaa's Sharman Networks adopted this very course of action when it incorporated in Vanuatu, but as the Australian court's ruling demonstrates, such tactics do not necessarily place one beyond the reach of the law. I have not yet seen evidence of a major shift in illegitimate services moving abroad, and in fact it is noteworthy that eDonkey testified at the hearing that it was in fact closing its doors. Additionally, the more countries who affirm or enact an inducement theory of liability or other means of secondary liability that reach peer-to-peer services, the fewer places there will be from which the pirates can operate. I will continue to work with the international intellectual property community to monitor the international effects, and we should be vigilant with respect to the potential development of illegitimate peer-to-peer services based abroad. To the extent that they present a problem, the United States should make efforts in trade negotiations and other discussions with foreign nations to ensure that there is no place on Earth where such pirate services can find a safe haven.

Although these recent court decisions represent substantial progress in combating piracy, these developments do not mean that online piracy will abruptly cease. There will always be people who try to make a quick buck off of other people's hard work, and we will have to remain diligent in combating piracy both domestically and abroad. Increased enforcement of copyright protection and mass public education can, I believe, go a long way to curbing piracy and providing legitimate online music services with a profitable marketplace. Streamlining the domestic music licensing scene, such as by reforming Section 115 of the Copyright Act, would also help to make legitimate services more competitive.

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Questions for the Gary Shapiro, President and CEO,
Consumer Electronics Association
October 5, 2005
"Protecting Copyright and Innovation in a Post-Grokster World"

1. Mr. Shapiro, your written testimony expresses support for H.R. 1201, Congressman Boucher's bill over in the House. Although you state that the bill codifies the *Betamax* doctrine, it does not appear to specifically set forth a legislative definition of what constitutes "substantial non-infringing uses." Can you clarify for the Committee your organization's view regarding the correct standard when measuring whether a technology is capable of a substantial non-infringing use?

The essence of the *Betamax* standard, and all of the precedent cited there by the Supreme Court, is to protect and promote innovation and risk-taking – this furthers the constitutional basis of intellectual property itself, which is "[t]o promote the Progress of Science and useful Arts ...." Therefore, we do not believe that the Court meant to adopt any single or particular definition, or even concept, of "substantial non-infringing uses," because to do so in terms of today's technology and business models would be to shortchange tomorrow's.

As the Court noted, categories of non-infringing use include both authorized uses and "fair use" under Section 107 of the Copyright Act. Fair use originated as an equitable judicial concept, and was not incorporated into the Act until early in the last century. Hence it is meant to be an evolving doctrine, to be developed by courts on a case by case basis, rather than a code of conduct.

One key on which we have focused, since the advent of VCRs, was on products that serve the "reasonable and customary" expectations of consumers. In other words, we do not believe that most consumers, in their use of lawfully acquired content, are "pirates." They desire to find, render, store, forward, and play back lawfully acquired content in a way that is fair to content providers, as well as one that serves their personal schedules and the needs of their families. Accordingly, it has been our view that devices whose designs enable consumers to meet such varied needs do serve fair uses, and therefore these uses are non-infringing even if not authorized, or objected to, by an owner or distributor of a copyrighted work. Hence, devices serving such uses should be considered within the protection of the *Betamax* standard, even if these devices have other uses – and as the Supreme Court said, even if in fact such uses might be "primary" – that might be held to be infringing. To rule otherwise would be, as the Supreme Court said, to absorb the rights of patentees into the rights of copyright owners (which require no formalities and have longer terms), and hence to "choke the wheels of commerce."

Even the "reasonable and customary" standard must be viewed with a sense of dynamism. New products also create new possibilities, expectations, and uses. If these are embraced by consumers with respect to lawfully acquired content, they presumptively

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also should also be considered "fair uses," and the innovation via which they are offered should deserve protection under the *Betamax* doctrine.

2. In your testimony, you state that the copyright law's current "statutory damages" provisions could prove to be ruinous for the technology industry. Do you think that Congress should limit statutory damages to cases of direct copyright infringement as opposed to secondary liability cases?

Yes. As we note above, development of the fair use doctrine is meant to occur on a case by case basis in which equities can be fairly balanced. It is the rarely courageous business, however, that is willing to risk its entire solvency on a court's resolution of a legal issue that is, by definition, a "grey area." Failure to address this problem by limiting statutory damages, as posited in this question, will mean that there will be fewer and fewer new products raising such issues, and fewer and fewer courts will be given the opportunity to address the most difficult legal questions.

In addition to depressing American innovation and consumer welfare, this will punt all new issues and uses into the lap of the Congress, which is not well equipped to address them on an ongoing, dynamic basis. This result will be the opposite of what the Founding Fathers and the drafters of the Copyright Act intended.

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Answers to Questions from Senator Specter
for Cary Sherman, President
Recording Industry Association of America
"Protecting Copyright and Innovation in a Post-Grokster World"

1. *The Supreme Court's Grokster opinion established a new inducement standard for secondary copyright infringement liability. How does the recording industry intend to use this newfound cause of action as part of its future enforcement efforts? Do you believe that the Court's inducement standard is clear enough to obviate the need for any legislative activity in this area?*

The *Grokster* decision allows content creators to hold liable those who are most responsible for the massive theft of copyrighted works that has occurred on peer-to-peer (P2P) file-sharing networks. While our (and others') enforcement efforts will continue against individuals who steal and distribute copyrighted works online, we are now able to stem this massive theft at the root of the problem: those businesses that facilitate, enable, and induce others to engage in such activity.

The inducement standard articulated in *Grokster*, like the theories of contributory and vicarious liability within Copyright Law, is centuries-old court-based doctrine that more precisely articulates the true holding of *Sony Betamax* which, the Court noted, "was never meant to foreclose rules of fault-based liability derived from the common law."

The Court's ruling and articulation of an inducement standard did not, in fact, grant us any new "powers." Instead, it restored the proper and common-sense notion that those engaged in secondary infringement may be held responsible for their actions. It pulled aside the veil of a gratuitously abused standard of "noninfringing use," and ensured that the Ninth Circuit's incorrect interpretation of *Sony Betamax* no longer requires courts to "ignore evidence of intent."

We have never been against P2P technology itself. (In fact, the ruling in *Grokster* has enabled promising services such as iMesh, Snocap, and others to finally gain traction in the legitimate P2P marketplace.) While some parties may believe the inducement standard creates uncertainty, the Court's holding merely establishes appropriate consequences for engaging in behavior whose "unlawful objective is unmistakable." The result will be increased innovation—and more certainty—in the legitimate marketplace.

"Clarification" from Congress is unnecessary and likely counterproductive at this time, threatening convolution upon a benchmark that has served so many so well. The record and examples of inappropriate behavior by businesses reflected in the Supreme Court decision provide a clear roadmap.

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2. *In Mr. Yagan's testimony before the Senate Judiciary Committee, he stated that the Grokster decision would have the unintended consequence of giving the offshore, rogue peer-to-peer providers with a market advantage, so to speak. Do you believe that the recording industry will be able to successfully work with peer-to-peer technologies in distributing copyrighted musical works to the everyday consumer? Further, should these technologies move offshore, how would you recommend Congress legislatively ensure the enforcement of American copyright protections against these technologies?*

Since *Grokster*, the P2P world has seen significant change. Several of the major offending services have closed up shop and the majority of computer users now know that unauthorized file-sharing of copyrighted works is illegal. More importantly, many formerly illicit services have announced their intention to go legit and a warmer climate has emerged for the legitimate online market. Content owners have embraced this sea-change and are working with services to provide consumers with more opportunity to obtain legal content than ever before.

Undoubtedly, some services will decline this opportunity to go legit and will instead choose to thwart enforcement efforts by altering the technology or even moving offshore. The vast majority of these businesses, however, understand that remaining illicit is an imprudent option. The Supreme Court's decision helped reveal these operations for the illegal fronts they were. Now advertisers and investors – the two main sources of income for P2P operators – are increasingly looking to the legitimate marketplace to place their money. Those businesses that choose to move offshore spotlight their illicit intent and will increasingly find investors (and supporters) unwilling to follow them.

3. *Some have interpreted the Grokster opinion as mandating the use of so-called "filtering technology" when a manufacturer creates a product that processes copyrighted materials. Indeed, the Committee has learned recently that the entertainment industry is working on a regulatory proposal with the Commerce Committee and FCC to mandate the use of filtering technologies on digital radio and broadcast signals. Does the industry intend to pursue similar mandates through our copyright laws?*

We have no plans to pursue tech mandates within the copyright laws. The *Grokster* decision set the stage for the growth of legitimate services, and the market itself will further guide those services wishing to provide consumers with the safest and best experience for acquiring legal content. Filtering technology is one proven method of providing such content. (In the case of digital radio and broadcast signals, we are unable to rely on the marketplace to achieve sensible results, because we are denied the requisite legal rights to bargain in the marketplace. The lack of a performance right for sound recordings, and the existence of a compulsory license for digital transmissions, leaves us unable to properly negotiate for use of our works. This market failure requires more direct involvement from appropriate agencies to level the playing field.)

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The Supreme Court referred to defendants' failure to use "filtering tools or other mechanisms to diminish the infringing activities using their software" as merely one example of "intentional facilitation of their users' infringement." While failure to use a filtering technology is therefore not itself dispositive of illicit intent, that coupled with other factors, and the availability of such effective filtering tools, may indicate a business warranting further review.

4. *As you are aware, Justices Breyer and Ginsburg submitted separate concurring opinions in the Grokster decision regarding their interpretation of the so called "Betamax doctrine." Because there appears to be ambiguity, do you believe that Congress should step in to clarify the meaning of this doctrine?*

The situations that the *Sony* case – and now the *Grokster* case – address present a wide array of circumstances that do not lend themselves to codification in a black and white rule. The *Sony* case actually reflects a nuanced judgment about how to balance protection for creators and protection for technology innovation.

It is important to keep in mind, however, that the *Sony* doctrine cannot be reduced to or summarized by a phrase chosen from the opinion, as defendants attempted to do in the *Grokster* case. Justice Ginsberg voiced frustration with this at oral argument when she stated, "I don't think you can take from what is a rather long opinion, and isolate one sentence, and say, 'Aha, we have a clear rule.'"

But courts have, by and large, done a very good job applying the doctrine to a wide range of facts and circumstances, and public policy is probably best served by allowing the courts to continue doing that.

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Answers to Questions from Senator Leahy
for Cary Sherman, President
Recording Industry Association of America
"Protecting Copyright and Innovation in a Post-Grokster World"

1. *We have heard a lot about filtering, especially since the Grokster decision was announced. When we say "filtering," we mean having a technology that can distinguish between digital files that copyright holders are willing to share, and those that they are not. Has anyone accomplished such filtering on a scale that would meet the demands of consumers? Is the available technology keeping pace with the demands of the law?*

As the *Grokster* case indicated, filtering is an important method that can be used to combat online piracy. Certainly, the level of effectiveness varies with the type of filter used and the genuine interest in its desired outcome. The most robust filters may be rendered useless if users are given a means to easily circumvent their implementation.

Filters can take many forms and serve many different purposes. The basic function of a filter is to distinguish or identify a digital file that could contain an application, a virus, spam, or some sort of "content" (e.g. music, movie, game, software).

Filters have existed for many years. The earliest ones were based on the metadata associated with the file, such as the name of the file, which could be the name of the artist, the song, the movie, the game. A metadata filter is then able to compare the metadata with a database containing content "claimed" by copyright holders and distinguish that file from others.

Filters can also distinguish content by using what is known as a hash value, or "hash" for short. This is a mathematical representation of the file in question. A filter can compare hash values of a file to a database containing hashes and determine if the files are the same.

The most effective filtering method utilizes a "fingerprint" to compare files to a database, and is particularly effective with music content. This technology has been around for a number of years. It is very similar to a physical fingerprint in that it extracts identifying data at specific locations within a file and then compares it to a database of fingerprints.

These techniques are utilized in a number of commercial applications. One example that is used by a great number of consumers is CDDB by Gracenote. CDDB is an application in the majority of media players. When consumers rip their CDs into a media player other than the Windows media player they use CDDB to identify it. The Gracenote application uses a combination of all three filter types and compares the file against a database of nearly 40 million recordings and returns to the consumer

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the metadata that automatically populates their media player. This application is used by millions of consumers everyday and is totally transparent to the user.

In short, filtering technology is available, effective, and in use today. It can and certainly should be used to protect copyrighted content.

2. *Many people treat the Grokster decision as if it ended the story on liability for inducing the infringement of copyright. The Supreme Court did write a strong opinion on the subject, but that case is back in the trial court, and there will doubtless be other cases brought. How do you see inducement liability developing in the trial courts, and what do you think the practical impact will be on consumers?*

The inducement theory will evolve in the same way as contributory and vicarious liability (or, for that matter, any legal theory based on an initial—and necessarily adaptable—set of parameters). Case law will likely borrow from those theories, as well as from patent law, from which they derived. Ultimately, however, the inducement standard will stand on its own, guided by the common-sense notion of responsibility and propriety. The Supreme Court laid out many examples of improper activity by defendants that will help guide businesses as they endeavor to go legit. As with any legal model, the guidelines undoubtedly will become even clearer as case law develops.

Again, the *Grokster* decision considers the *actions* of a business or individual, not the technology itself (that is left to the untouched *Sony* "non-infringing use" standard). As such, it in no way hampers those developers that adhere to the customary standards of responsible businesses, and allows the advancement of technology to remain unimpeded. The *Grokster* decision merely provides an environment more conducive to the growth of legitimate businesses. Consumers will benefit by the increase in opportunities and means to acquire content legally.

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Questions for Sam Yagan, President, MetaMachine
October 5, 2005
"Protecting Copyright and Innovation in a Post-Grokster World"

1. **Your written testimony states that an earlier round of negotiations ended when major labels requested that you "do things with the eDonkey application which I simply could not do technologically, ethically, or without taking on even more legal exposure." Could you elaborate?**

Several non-disclosure agreements prohibit me from speaking specifically about the details of my negotiations. However, I believe that I can adequately answer your question without revealing specifics of the discussions. Please let me know if you require more information.

a.) Technologically

Consistently throughout my negotiations with many parties in the entertainment industry, executives demanded 100% elimination of copyright infringement. Unfortunately, no technology exists with that degree of efficacy. Moreover, some individuals requested elimination of all pornographic files from sharing on the application. As much as one may abhor illegal pornography, this likewise represents an impossible technological hurdle currently. I believe that no such technology exists today.

Members of the entertainment industry also requested that we force an upgrade on all of our users so that they could no longer use older versions of the eDonkey software. Obviously, doing so would have required that we had designed that capability into the previous versions, which we had not done.

b.) Ethically

The recent spyware scandal related to one major label's deployment of a copy-protection solution that demonstrated disregard for consumers' rights exemplifies the type of activity considered acceptable by some parties within the entertainment industry, which we also encountered. Executives requested that we delete files on users' computers (as opposed to simply blocking certain transfers) without knowing whether the users had acquired such files legally. I also considered the request to auto-upgrade our users – even if technically feasible – to be unethical.

c.) Legal Exposure

A full description of the various legal liabilities that might accompany such changes in the eDonkey software would fill tomes. Within the narrow context of copyright infringement liability, however, the added knowledge and control over our users would have changed eDonkey's legal exposure as I understood the relevant laws. I was willing to consider engaging in new development work related to certain of these options, to which we did not have ethical concerns as noted above, if the entertainment industry

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would have agreed that they would not engage in litigation based on these changes, which they would not do.

2. **In your testimony before the Senate Judiciary Committee, you stated that you believed the real winners of the *Grokster* decision would be the "offshore, rogue P2P developers who will have just lost half a dozen of their most legitimate competitors." Given this possibility, what recommendations would you make to the Judiciary Committee to counter this possible consequence?**

I am humbled by your request to advise the Judiciary Committee. The Internet serves as a global distribution medium that does not, by its structural nature, acknowledge geographic boundaries. Therefore, jurisdictional issues present particular challenges with respect to the imposition of rules to govern the behavior of Internet-based software distributors and their use by Americans. So long as any one jurisdiction allows the development of a P2P file-sharing application, rogue developers will have the ability to make their software available globally.

With that in mind, the Judiciary Committee might consider legislation that would encourage development and organization of P2P companies in the United States for legitimate purposes while simultaneously – but separately – overseeing the issue of digital copyright infringement. In other words, I would respectfully recommend *disaggregating* the issues of P2P advancement and copyright infringement. Keeping the two aggregated may result in some reduction of domestic, P2P-based copyright infringement, but will have minimal effect on either: (i.) domestic, non-P2P copyright infringement, or (ii.) non-domestic P2P-based copyright infringement. Neither of these outcomes will have the desired effect.

I believe the following alternatives will have the desired effect of reducing digital copyright infringement:

a.) Make it easier to prosecute direct infringement. I believe that the indirect infringement aspect has received too much focus, when of course the fundamental problem lies with the direct infringers.

b.) Make it much easier for anyone (including, but not limited to, P2P developers) to license music from the major labels. Most P2P developers would far prefer to earn revenue by monetizing musical content as paid downloads, subscriptions, or in advertising-sponsored formats, rather than by selling contextually irrelevant ads.

c.) Encourage innovation in P2P technologies and business models. The ambiguity of the Supreme Court's decision has chilled P2P innovation in the United States and pushed entrepreneurs in this field offshore. It has also stifled advances in digital rights management and creative uses of digital distribution that would advance P2P and make it more attractive to content rights holders. In order to have any hope of

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constructively influencing the development of this industry, we should encourage rather than discourage these companies to domicile themselves in this country.

3. **In your testimony, you urged the Judiciary Committee to remember that although companies like eDonkey may cease to exist, the peer-to-peer technology still will. In light of these comments, could you make any recommendations to the Committee of how we might strike a legislative balance in protecting the rights of copyright holders while fostering new and emerging technologies like peer-to-peer applications?**

Thank you for again asking me to advise the Judiciary Committee. If it was my responsibility to craft legislation in this area, I would start with a few fundamental assumptions:

a.) Technology will continue to advance independently of US law. US law will primarily influence where that advancement takes place and who profits from it.

b.) File transfer technology will evolve in many directions, but specifically in the direction of (i.) increased anonymity and (ii.) increased encryption. In fact, it would be prudent to assume that in the near future, a P2P application will emerge outside of US jurisdiction that offers encrypted file transfers and nearly perfect anonymity to its users.

c.) Many of the P2P software developers in the post-*Grokster* era will not have a profit motive and will not organize themselves into formal structures such as corporations.

From these three points, I would conclude that in a technological arms race, the thousands of off-shore individual peer-to-peer developers will generally stay a step (or two) ahead of the slower-moving large copyright owners. I would also conclude that litigating against these individuals will not yield satisfactory results for US copyright owners. Finally, I would conclude that, in lieu of a profit motive, some of these developers may have true "anarchist" ambitions.

I would then consider the following characteristics for the legislation in question:

a.) The legislation must have a broad base of buy-in among Americans. Ultimately, end-users, not software developers, infringe copyright.

b.) Copyright owners – not Congress – should take responsibility for protecting their creative assets. Clearly we should not condone theft, but if someone leaves the trunk of his car open day after day, and every day reports a theft, should we hire an extra policeman to patrol that block or tell the individual to close and lock his trunk?

c.) Trust the market. When the government has provided clearly defined laws and regulations, and where consumers have proven the existence of a large market –

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innovators and entrepreneurs will take it from there. In this case, this means creating a straightforward mechanism for new P2P developers to have access and to license tracks from the major labels. How can we expect "legitimate" new technologies and business models without legitimate access to major label content?

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Questions Submitted by Patrick Leahy
"Protecting Copyright and Innovation in a Post-Grokster World"
October 5, 2005

Questions for Sam Yagan:

1. **We have heard a lot about filtering, especially since the Grokster decision was announced. When we say "filtering", we mean having a technology that can distinguish between digital files that copyright holders are willing to share, and those that they are not. Has anyone accomplished such filtering on a scale that would meet the demands of consumers? Is the available technology keeping pace with the demands of the law?**

I understand that iMesh has launched a filtered P2P software product using a music-industry-sanctioned filtering vendor; I have also read press reports detailing failures in its reliability. As I have surveyed the vendors of filtering products, three critical issues stand in the way of what I consider a commercially viable solution: (a.) cost; (b.) efficacy; and (c.) scalability.

a.) Cost

Once a vendor has a potentially viable technology, there remain significant integration costs. One vendor required a six-figure advance for the integration work in addition to the following fees: database management fees; system integration fees; transaction fees; seeding fees; and consulting fees. This does not include the thousands of hours of labor that my employees would have to spend on the client-side of the integration.

b.) Efficacy

To the best of my knowledge, none of the existing products can filter copyrighted files with 100% efficacy. As Napster learned several years ago, "close" does not provide a solid defense against secondary infringement. I fear that implementing a technology that correctly identifies and filters, say, 90% of the infringing files could expose us to the specific knowledge of those infringing files. As a result, in order for a filtering solution to suffice, it would need to demonstrate virtually perfect reliability or offer relief from potential liability.

c.) Scalability

Peer-to-peer applications have demonstrated remarkable scalability and their distributed nature provides specific challenges to the introduction of any "central server" that would handle file identification and filtering. One may counter that centralized applications may provide certain advantages to the decentralized environment. Regardless, however, a software developer should not have to change the design of his system to accommodate a third-party vendor.

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I find it difficult to directly answer the second part of your question; I will provide three observations that I hope you find responsive.

First, to the best of my knowledge, the law has made no demands for specifics of filtering technologies. From a structural perspective, it seems that the most efficient means is for content owners to use whatever technologies they deem necessary to protect their assets.

For example, the US Treasury does not require every cash register in the country to be outfitted with technology to identify counterfeit dollars. Rather, the US Treasury understands the value of its "product" and invests in sufficient technologies to make counterfeiting more difficult.

Second, in order to provide incentives for entrepreneurs like me to develop new innovative technologies, we must see a significant market for our product. As long as the loudest voices in the entertainment industry speak out against P2P and in the language of "filtering and blocking," entrepreneurs will not likely see an iTunes-like market.

However, imagine if entertainment industry executives communicated a desire to reinvent the way music is distributed and paid for in response to digital distribution technology advancements. Imagine if they showed interest in digital ad-supported music, for example. Then entrepreneurs would come to the rescue, bringing hundreds of new ideas and new technologies to the marketplace. Indeed, I find it difficult to imagine any laws or lawyers who can motivate innovation more than a market.

Third, consider this analogy: if radio or television broadcasting industries had – from their inception – required business models that were predicated on blocking program reception from audience members who did not pay for them, they would have missed the first seventy-five increasingly profitable years of development of these industries.

Only long after robust free-to-viewer and free-to-listener television and radio broadcast industries established themselves with advertising support—and then only after several false-starts – did subscription and on-demand models enhance the underlying ad-supported businesses. Perhaps those executives and officials evaluating peer-to-peer technology could find guidance from the radio and television experiences.

2. **Many people treat the Grokster decision as if it ended the story on liability for inducing the infringement of copyright. The Supreme Court did write a strong opinion on the subject, but that case is back in the trial court, and there will doubtless be other cases brought. How do you see inducement liability developing in the trial courts, and what do you think the practical impact will be on consumers?**

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I sought to address this issue in my written testimony; I will gladly expand on this question here. I believe that in a given year any one of the major recording companies spends more on legal fees than the entire peer-to-peer industry earns in revenue. Thus, although companies like mine stand a good chance of winning on the basis of *Grokster*, few, if any, can afford to do so.

I find it difficult to predict how inducement liability will develop in the trial courts. The Court in *Grokster* clearly had the intent of drafting a decision that would exclusively isolate peer-to-peer companies as guilty parties. However, the manner in which the Court did so applied somewhat narrowly to the specific fact pattern found in *Grokster*. I posed the following thought question in my oral testimony:

> My final point on Grokster is that its inducement standard is not sustainable as a long-term equilibrium. Imagine if since eDonkey's inception not only had we not made any statements inducing infringement but that we made no statements at all other than simply putting up a website that read "eDonkey is a peer-to-peer file-sharing application." It seems to me that this would not qualify as "affirmatively and actively inducing infringement." If we had never made any other statements would be in the clear now? If so, new P2P applications will inevitably spring up and easily satisfy Grokster in this way. If we would not be in the clear then the effect of Grokster will go far beyond merely chilling innovation – it will almost certainly freeze it in its tracks.

If the trial courts would find the above example liable under *Grokster*, this will effectively put an end to development and distribution of peer-to-peer applications in this country. However, it will have the side effect of disemboweling innovation in America. If the trial courts find the above example to comply with *Grokster*, then the practical impact on consumers – and the larger marketplace – will be virtually zero. Either way, current P2P software programs will continue to work for their users and independent offshore open-source developers will keep new ones updated.

So, in my opinion, *Grokster* can only function as a short-term band-aid.

3. **In your testimony, you discussed the possibility of open source projects becoming a popular method of piracy and copyright violations. Do you think that there is an inevitable amount of copyright theft on the Internet, and if so, at what level?**

No. I do not believe that mass copyright infringement must accompany digital distribution of content. Of course, some amount of "structural" copyright infringement took place in the analog era and the RIAA/MPAA took relatively modest actions to reduce such infringements. I believe that three factors will determine how much copyright infringement takes place on the Internet: evolution of copyright law; enforcement efforts by copyright owners; and how business models evolve.

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a.) Evolution of Copyright Law

Many in the public have come to have a negative view of copyright laws. When new legislation extends copyright protection, consumers find it more morally justifiable to circumvent these laws that they perceive benefit large companies and wealthy celebrities at their expense. I believe that if copyright law continues on its trajectory of favoring private entertainment industry interests over the public domain, copyright infringement will continue to increase. Conversely, if consumers had access to a thriving public domain, they would likely begin to have increasing respect for copyrighted content; I predict copyright infringement would then decline.

b.) Enforcement Efforts

I believe that the RIAA claims its ongoing "John Doe" lawsuits have indeed reduced copyright infringement. Third party data from sources such as BigChampagne seem to refute that evidence. Obviously the entertainment industry's actions do have some effect on the level of infringement. As a thought question: how much copyright infringement would take place if consumers had a positive opinion of record labels? In asking this rhetorical question, I do not make excuses for the infringers; instead I seek to identify practical approaches that I would pursue as an entertainment industry executive.

c.) Business Models

What if consumers could:

i.) Listen to a song once a month for free, but the second listening in any month required purchase?
ii.) Buy a song for a nickel?
iii.) Choose to listen to an unlimited number of songs with embedded ads?

I believe that any one of these (and one could come up with many more) use rules would have the effect of increasing profits and reducing copyright infringement. Soon the CD will go the way of the cassette tape and everyone will acquire their music online. As that happens, will the business models change to accommodate the new medium?

4. In your testimony, you made the point that private providers of p2p networks, entertainment executives, and the government should work together to harness the available technology and use it wisely, thwarting efforts to use the vast networks illegally. What, more precisely, do you propose?

I did not make this suggestion only because it would help my company. Rather, I have looked at the situation from the side of the entertainment industry and asked the following question: what advantages do well-funded American corporations have over unorganized, open-source projects?

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Simply put, I have the ability to bind my company in a business relationship with the entertainment industry. I can agree to add, remove, or change certain elements of the eDonkey product. I can agree to help the entertainment industry pursue its financial and strategic goals. The American judicial system also provides recourse should I fall short of my commitments. None of the above applies to a disparate group of open-source developers.

I propose that everyone look at the situation as follows. We have two extremes in the marketplace for downloadable music. On the one end, iTunes, Rhapsody, Napster, and Yahoo! have provided numerous venues for buying digital music in a fairly traditional way. On the other end, open-source file-sharing applications like eMule and Frostwire provide users an environment in which to download any kind of unlicensed file, for free.

In the existing popular P2P applications, the recording industry has a unique weapon to combat the "rogue" open-source applications. The question boils down to this: can we come up with a "walled garden" that can successfully compete with the free, rogue open-source clients? I believe we can.

I propose offering users who register (this alone would generate a wealth of information for the entertainment industry!) for an authorized P2P application a vast array of free licensed music, monetized through advertising. (Remember the alternative: users can go get the free music at the rogue applications anyway.) Of course, the users would not have unfettered access. Perhaps they could only access low bit-rate recordings. Or perhaps they could only listen to a song with a limited frequency (but with no cap on the total listens). These solutions would require filtering and licensing and a partnership between the technologists and the rights owners.

But the challenge, of course, is "competing with free," meaning unlicensed and un-monetized content I believe that my proposal could not only "compete with free" in the marketplace, but also generate revenue and give the entertainment industry a wealth of customer data, considerable control in how users share their content, and a say in the evolution of the peer-to-peer industry. To me, that sounds substantially better than the current situation.

I would also propose promoting programs such as those put forth by the Distributed Computing Industry Association (www.DCIA.info), of which MetaMachine, Inc. is a Member.

For business models to succeed in the evolving digital distribution environment, they must work with current and foreseeable P2P applications, including open-source clients and swarming transfer protocols.

Digital entertainment business models should address both the intentional authorized introduction by rights holders and their agents of secured files of copyrighted works (and their continued protection as they are redistributed from user-to-user no matter what software program(s) are being used) as well as the unauthorized introduction of

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unsecured files of such works by third parties including end-users (and their continued prevention from being redistributed in unauthorized form).

The DCIA has described two fundamental tasks to accomplish with respect to securely redistributing copyrighted works:

First, P2P digital rights management (DRM) should be applied to each file (permitting rights-holders to set prices or imbed ads, define usage terms, etc.), then multiple variations of the secured licensed version of the file must be created (supporting robust viral redistribution), and finally these initial authorized copies must be seeded into the file-sharing environment.

Second, a system must be supported that essentially mirrors the decentralized architecture of the new "darknet" P2P applications, extended to include torrent technologies, that blocks redistribution of unauthorized files of registered copyrighted works (without comprising consumer privacy or interfering with redistribution of other files), that reconstitutes usable quality-controlled portions of copyrighted-works files into licensed versions (to optimize the efficiency of a distributed computing environment), and that provides detailed specific measurement data regarding file traffic.

34113.030

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

April 25, 2006

The Honorable Arlen Specter
Chairman
Committee on the the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Please find enclosed responses to questions arising from the September 28, 2005, appearance before the Committee of United States Attorney Debra Wong Yang at a hearing entitled, "Protecting Copyright and Innovation in a Post-*Grokster* World." We hope this information is useful to the Committee.

Thank you for the opportunity to present our views. Please do not hesitate to call upon us if we may be of additional assistance. The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to submission of this letter.

Sincerely,

William E. Moschella

William E. Moschella
Assistant Attorney General

cc: The Honorable Patrick J. Leahy
Ranking Minority Member

34113.031

September 28, 2005
Hearing on
"Protecting Copyright and Innovation in a Post-Grokster World"
Committee on the Judiciary
United States Senate

Questions for
Debra Wong Yang
United States Attorney
Central District of California

1. **You noted in your testimony that there were eighteen (18) Cyber-Hacking and Intellectual Property (CHIP) Units throughout the country. Could you please provide some background information on these units? Specifically, could you please provide the Judiciary Committee with the following information: the individual(s) who decide where the units are located; the process by which this person(s) decide where they are located; the factors that are considered when determining the allocation of resources amongst the units; and, the areas that are in need of a CHIP unit.**

Computer & Telecommunications Coordinators (CTCs)/CHIP Coordinators

In 1995, the Department of Justice created the Computer & Telecommunications Coordinator ("CTC") program to address concerns about the rising tide of computer crime. The CTC Program designated at least one Assistant United States Attorney ("AUSA") in each United States Attorney's Office as a CTC, and some districts designated more than one prosecutor, depending on the needs of the particular region. In addition, a number of components and divisions within the Department of Justice, such as the Tax Division, also designated CTCs for their respective organizations.

Under the CTC program, the prosecutors were assigned four areas of responsibility: (1) prosecuting computer crime; (2) serving as a technical advisor for other prosecutors and law enforcement agents; (3) assisting other CTCs in multi-district investigations; and (4) providing training and community outreach regarding computer-related issues. In October 2004, the Department of Justice's Task Force on Intellectual Property recommended that the CTC designation be changed to "CHIP Coordinator" to clarify that intellectual property offenses were included within the responsibilities of the AUSAs and align all 94 United States Attorneys' Offices with the Attorney General's CHIP program explained below. There are approximately 230 CHIP Coordinators, including CHIP Unit prosecutors, designated to handle both computer crime and intellectual property matters.

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CHIP Units

In July 2001, the Justice Department created 10 Computer Hacking and Intellectual Property ("CHIP") units to address the increasing threat of cyber crime and intellectual property offenses in specific regions of the country. The program was expanded twice, once in 2002 and again in 2004. The offices were chosen based on the crime problems and victim industries within the particular district.

The CHIP Program was created to augment the number of prosecutors designated as CTCs, described above, who served in every United States Attorney's Office. The Department provided districts with additional funding to hire prosecutors and support personnel to form the units and focus on fighting intellectual property and cyber offenses.

The CHIP unit prosecutors focus on prosecuting intellectual property offenses such as trademark violations, copyright infringement, and thefts of trade secrets. In addition, they prosecute high-technology offenses, including computer hacking, virus and worm proliferation, Internet fraud, and other attacks on computer systems.

In addition to prosecuting cases, CHIP unit prosecutors also are involved actively in training other prosecutors and Federal agents regarding high-tech investigations, and they work closely with victims of intellectual property theft and cyber crime on prevention efforts.

The first CHIP unit was created in February 2000, in the United States Attorney's Office in San Jose, California, to address cyber crime and intellectual property cases in the Silicon Valley area. Based on the success of the CHIP unit in San Jose, in 2001 and 2002, then-Attorney General John Ashcroft expanded the program to include 11 cities in addition to San Jose, California:

* Alexandria, Virginia
* Atlanta, Georgia
* Boston, Massachusetts
* Chicago, Illinois
* Dallas, Texas
* Kansas City, Missouri
* Los Angeles, California
* Miami, Florida
* New York, New York (Brooklyn and Manhattan)
* San Diego, California
* Seattle, Washington

In October 2004, the Department of Justice created five additional CHIP units in:

* Nashville, Tennessee
* Orlando, Florida

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* Pittsburgh, Pennsylvania
* Sacramento, California
* Washington, D.C.

These last five units were created pursuant to the findings and recommendations of the Department's Task Force on Intellectual Property, which issued its report in October 2004. There currently are 18 CHIP units, with a total of approximately 73 Federal prosecutors allocated to address intellectual property and cyber crime cases, in addition to the approximately 160 CHIP coordinators in the remaining districts and Justice Department divisions. Attached as Exhibit A is a chart specifying the number of AUSAs allocated for each of the CHIP units.

2. **With regard to the focus of the CHIP units on intellectual property matters, please provide the following information for each unit: the number of prosecutors assigned, indicating how much time/prosecutors are devoted to investigating intellectual property violations; the number of criminal intellectual property violations pursued, indicating the number of successful convictions and sentence imposed whether by plea or verdict; and, what additional resources are needed to ensure that more criminal intellectual property violations are pursued.**

A chart showing the number of prosecutors assigned to each CHIP Unit is attached as Exhibit A. This data does not indicate the number of hours devoted to investigating and prosecuting intellectual property crimes because, currently, that information cannot be collected accurately. A time code for intellectual property is being created that, once implemented, will allow the collection of this data.

A chart showing, by district, the number of criminal intellectual property cases filed, defendants charged, defendants convicted, and the sentencing range imposed, is attached as Exhibit B-1. For comparison purposes, the chart also shows the same information for all of the United States Attorneys' Offices in all districts, including those districts that do not have a CHIP unit.

Attached as Exhibit B-2 is a bar chart showing the number of cases filed and defendants charged in all districts between FY 2001 and FY 2005. The most significant jump occurred this past year: 350 defendants were charged with intellectual property offenses in FY 2005, nearly doubling the 177 defendants charged in FY 2004.

A similar jump took place in districts with CHIP units. As shown in Exhibit B-3, the number of defendants charged in CHIP districts climbed from 109 in FY 2004 to 180 in FY 2005, a 65% increase.

We note that, historically, Justice Department-compiled statistics have under-reported the number of Federal intellectual property prosecutions across the country. For example, the statistics for intellectual property prosecutions do not include intellectual

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property cases charged and reported solely as conspiracies (18 U.S.C. § 371) – a common lead charge in cases involving organized groups and multi-jurisdictional criminal activity

As far as additional resources, the Administration recently has presented its FY 2007 budget request. The Department expects to continue using its base budget in an effective manner to prosecute intellectual property and cyber crime cases vigorously.

3. **Are the CHIP units currently coordinating efforts to investigate intellectual property violations with any other government agencies (i.e. an FBI "cybersquad," the Bureau of Immigration and Customs Enforcement, and United States Secret Service)? If so, for each coordinating agency, please provide the following information: the division within the coordinating agency working with the CHIP unit and, if necessary, indicate which unit the agency is working with; the number of agents assigned to work with the units, indicating where they are assigned; whether the agents serve in a full or part-time capacity; and, indicating the number of successful convictions and sentence imposed whether by plea or verdict. Would increased coordination with other agencies increase the number of successful criminal prosecutions? If yes, please give your suggestions for how the CHIP Units might better coordinate their efforts with other agencies.**

CHIP unit prosecutors coordinate with other law enforcement agencies to investigate intellectual property crimes. On the Federal level, primary jurisdiction over intellectual property offenses rests with the Federal Bureau of Investigation ("FBI") and U.S. Immigration and Customs Enforcement ("ICE"), the latter because most of the counterfeit and infringing products distributed in this country are manufactured abroad. Intellectual property prosecutors work with other Federal agencies as well: the Food and Drug Administration's Office of Criminal Investigations in counterfeit drug cases; the Postal Inspection Service in cases where counterfeit products are distributed through the mail; the Office of Consumer Protection in cases where the counterfeit products pose a risk of harm to the consuming public; and IRS Criminal Investigation in cases involving related tax offenses or money laundering.

Although thousands of cases a year are investigated by State and local authorities and are prosecuted in State and local courts, some investigations may result in Federal prosecution if the offense meets Federal criteria. Certain CHIP units are located in districts with a multi-agency task force, which provides another source for coordination and intellectual property case generation.

Federal investigators are sometimes, but rarely, assigned to work intellectual property cases full-time, although such full-time assignments can occur if an agent is working on a complicated intellectual property case or group of cases that warrant the allocation of substantial resources.

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In the Central District of California, for example, the FBI maintains two Cyber Squads with a total of 21 agents when fully staffed. In addition to intellectual property offenses, the squads are responsible for investigating Internet fraud, including Internet-based identity theft, computer intrusions and other cyber crimes. ICE has assigned eight agents to work intellectual property offenses full-time and they are assigned to the Trade Fraud Group in Los Angeles. Los Angeles also has an active Electronic Crimes Task Force ("ECTF"), consisting of over 35 investigators from the Secret Service, the FBI, the Los Angeles District Attorney's Office, the Los Angeles Police Department, the Los Angeles Sheriff's Department, the Internal Revenue Service, and the California Highway Patrol. The ECTF generates cases pursued in Federal court through Federal law enforcement agencies. Case statistics are set forth in the answer to Question 2.

CHIP prosecutors have not identified lack of coordination as an obstacle to effective IP law enforcement. To the contrary, although the involvement of multiple law enforcement agencies sometimes creates coordination concerns, the risk of duplicative efforts or other adverse consequences are far outweighed by the benefits obtained by the creative leveraging of multiple sources of law enforcement resources to IP prosecution.

4. **Of the thirty-five (35) attorneys in the Computer Crime and Intellectual Property Section (CCIPS) of the Criminal Division, please provide the following information: the relative amount of time devoted exclusively to intellectual property violations, indicating the number of attorneys committed full or part-time to intellectual property matters; the number of violations pursued and their outcome; and, whether other agencies are working with the CCIPS prosecutors.**

Currently, CCIPS has 13 attorneys devoted to intellectual property enforcement, including a Deputy Chief for Intellectual Property, whose primary responsibility is to oversee and manage CCIPS's intellectual property enforcement program. These attorneys work full-time on intellectual property criminal issues, including the prosecution of cases, intellectual property policy and legislative reform, and international training and technical assistance. CCIPS's prosecution strategy stresses the development of multi-district and international investigations, and prosecutions of organized criminal groups engaged in large-scale intellectual property theft.

CCIPS's intellectual property prosecutions have increased dramatically in recent years. For instance, at the beginning of FY 2002 (October 1, 2001), CCIPS had 23 pending criminal intellectual property cases and investigations for which it was responsible; at the beginning of FY 2006 (October 1, 2005), there were 203 pending intellectual property cases and investigations.[1] That constitutes nearly an 800% increase

[1]Because investigations are opened to determine whether a prosecutable violation has occurred, not all open investigations will result in a charge and conviction.

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in prosecution workload in four years. During the same time frame, CCIPS prosecutions resulted in 103 convictions for intellectual property offenses. Since CCIPS prosecutes its cases in the various Federal judicial districts in which there are United States Attorneys' Offices, the cases filed and defendants charged by CCIPS attorneys are included in the case statistics appearing in Exhibit B-2.

Although CCIPS prosecutors have been lead counsel in a majority of these matters, they work closely with prosecutors throughout the CHIP network, both during the investigative and prosecution phases of the cases. CCIPS prosecutors also work closely with investigating agencies, including the FBI and ICE. For instance, in one of the first large-scale Internet software piracy investigations and prosecutions (*Operation Buccaneer*), CCIPS and ICE (then the Customs Service) led an 18-month, undercover investigation, culminating in more than 70 searches in six countries in December 2001. *Operation Buccaneer* has since led to 30 felony convictions in the United States, 10 overseas, and some of the longest sentences ever imposed for online copyright crimes: from 27 to 50 months imprisonment.

More recently, CCIPS worked closely with CHIP prosecutors and the FBI to develop two additional, large-scale, international investigations focusing on organized online software piracy: *Operations FastLink* and *Site Down*. In *Operation FastLink*, law enforcement in 12 cooperating countries executed in April 2004 over 120 search warrants against dozens of online piracy criminals. Similarly, *Operation Site Down* culminated in the execution in June 2005 of over 90 search warrants by law enforcement in 12 countries around the world. Together these operations resulted in the confiscation of hundreds of computers and illegal online distribution hubs, and the removal of more than 100 million dollars worth of illegally-copied copyrighted software, games, movies, and music from illicit distribution channels. Countries participating in these United States-led operations included: France, Canada, Sweden, Denmark, the Netherlands, the United Kingdom, Portugal, Hungary, Israel, Spain, Australia, Singapore, Belgium, Brazil, and Germany. *Operation FastLink* has yielded 26 felony convictions to date, while *Operation Site Down*, in which searches were executed only nine months ago, has led to the indictment of 44 defendants and 17 convictions obtained by the United States Attorney's Office for the Northern District of California – including the first convictions for illegal camcording and online distribution of pre-release works, under the recently-enacted Family Entertainment and Copyright Act.

6. **Your testimony indicates that many of the recommendations contained in the Department's October 2004 Intellectual Property Task Force Report have been implemented by Attorney General Gonzales. What specific recommendations from that report have yet to be implemented? What are the Department of Justice's top intellectual property priorities for the coming year?**

In March 2004, then-Attorney General John Ashcroft created the Department of Justice's Task Force on Intellectual Property to examine the Justice Department's efforts

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in addressing the increasing problem of intellectual property theft. The Task Force examined how the Department protects intellectual property through criminal, civil, and antitrust enforcement, legislation, international coordination, and prevention. In October 2004, the Task Force released its report recommending significant and comprehensive improvements in the Department's efforts to protect the Nation's intellectual resources. Some of the Department of Justice's accomplishments since the report was released are set forth below.

Criminal Enforcement Accomplishments

- Continued to dismantle and prosecute multi-district and international criminal organizations that commit intellectual property crimes, including:
  - leading the international law enforcement effort against members of over 22 major online software piracy groups in *Operation Site Down* in June 2005, which involved 12 countries, the simultaneous execution of over 90 searches worldwide, and the eradication of at least eight major online distribution sites; prosecutors have obtained indictments against 44 defendants and 17 convictions to date;
  - shutting down a sophisticated international peer-to-peer network known as "Elite Torrents," used by 133,794 members, in the first-ever criminal action against a BitTorrent file-sharing network;
  - obtaining felony conspiracy and copyright convictions against 26 software, music, and movie pirates as part of the ongoing *Operation FastLink*, the largest law enforcement action ever taken against online intellectual property offenders; and
  - obtaining convictions against two Los Angeles-area men for conspiracy and trafficking in over 700,000 counterfeit Viagra tablets manufactured in China and worth over $5.6 million.
- By the end of FY 2005, increased the number of defendants prosecuted for intellectual property offenses by 97% since the issuance of the intellectual property task force report in October 2004.
- Provided training to over 200 Federal cyber and intellectual prosecutors in Albuquerque, New Mexico, regarding computer crime and intellectual property offenses and issues.
- Provided a comprehensive training program in New York City on various aspects of criminal intellectual property prosecution for all CHIP coordinators, and provided regional training and guidance to prosecutors and Federal agents in Los Angeles.

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- Distributed over 1,000 copies of the report of the Task Force on Intellectual Property, and electronically distributed thousands more. The report contains a checklist to help potential victims report intellectual property crime to law enforcement officials.

- Expanded CHIP units in San Jose and Los Angeles and created five CHIP units in the United States Attorneys' Offices in Nashville, Orlando, Pittsburgh, Sacramento, and Washington D.C., bringing the total number of specialized units to 18.

International Cooperation Accomplishments

- Participated in interagency trips to Asia and Europe through the Strategy Targeting Organized Piracy Initiative ("STOP!") to encourage international partnerships to protect intellectual property rights and international cooperation in criminal enforcement.

- Engaged in law enforcement-to-law enforcement discussions with the Chinese government on criminal enforcement of intellectual property rights through the United States-China Joint Liaison Group.

- Executed agreements to implement obligations of the United States/European Union Mutual Legal Assistance and Extradition Agreements that ensure cooperation regarding intellectual property crimes with Austria, Belgium, Denmark, Finland, France, Hungary, Ireland, Latvia, Lithuania, Luxembourg, the Netherlands, Portugal, Slovenia, Spain, Sweden, and the United Kingdom; and completed negotiations with the nine remaining EU countries (Cyprus, the Czech Republic, Estonia, Germany, Greece, Italy, Malta, Poland, Slovakia).

- In the last year alone, CCIPS prosecutors met with more than 2,000 prosecutors, investigators, judges, and intellectual property experts from 94 countries to provide training and technical assistance, to learn about the nature and scope of criminal intellectual property offenses in foreign countries, and to develop the type of law enforcement contacts necessary for better coordination of international protection of intellectual property rights.

- Deployed a Federal prosecutor based in Bangkok, Thailand, as the intellectual property law enforcement coordinator ("IPLEC") to coordinate intellectual property issues and training, and to assist in United States-based enforcement actions in the Asian region.

Civil Enforcement Accomplishments

- Continued intervening in Federal and State court actions to defend copyright

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owners' use of civil subpoenas to identify anonymous Internet users allegedly engaged in copyright infringement.

- Filed an *amicus curiae* brief and participated in oral arguments before the Supreme Court in *MGM v. Grokster*, arguing that the court of appeals had adopted an unduly narrow view of the scope of secondary liability for copyright infringement.

Antitrust Accomplishments

- Presented over 15 public speeches by senior Department of Justice antitrust attorneys regarding international convergence, enforcement policies, and the Department's views on the right of intellectual property owners to decide independently whether to license.

- Participated in discussions with the Fair Trade Commissions of Japan, Taiwan, and Korea regarding appropriate intellectual property and antitrust laws.

Legislative Accomplishments

- Worked with Congress to achieve the following legislative accomplishments:

  - legislation recognizing the passive sharing of copyrighted works, as enacted in the Family Entertainment and Copyright Act, S. 167, on April 27, 2005;

  - legislation recognizing the premium value of copyrighted works before they are released to the public, as enacted in the Family Entertainment and Copyright Act, S. 167, on April 27, 2005; and

  - legislation allowing law enforcement officials to seize material and equipment used to make counterfeit products and labels, as enacted in the Anti-Counterfeiting Amendments of 2004, H.R. 3632, on December 23, 2005.

- Presented to Congress the President's draft legislation entitled the "Intellectual Property Protection Act of 2005," which toughens penalties for intellectual property crimes, expands criminal intellectual property protections, and adds investigative tools for criminal and civil intellectual property rights enforcement.

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Prevention Accomplishments

- Then-Attorney General John Ashcroft participated in a national education and prevention program at the Department of Justice entitled "Activate Your Mind: Protect Your Ideas," involving over 100 area high school students and presentations by songwriters, Department of Justice officials, victim representatives, and students regarding the impact of piracy. The event was filmed by Court TV and broadcast to thousands of high school students.

- Attorney General Alberto Gonzales participated in the second installment of Court TV's "Activate Your Mind: Protect Your Ideas" program at UCLA, with over 120 high school students, to discuss movie and television piracy and the importance of protecting creativity.

- Conducted an anti-piracy educational campaign with numerous presentations by a convicted intellectual property offender who developed informational materials and an anti-piracy informational video.

- The Justice Department is coordinating with other Federal agencies through the STOP initiative to raise awareness of Intellectual Property Rights.

Recommendations in Progress

In addition to the numerous recommendations that we implemented, as set forth above, the Department continues to diligently implement the remaining recommendations. For example, the Department currently is seeking funding for additional attorneys for the CCIPS, which is reflected in the President's Fiscal Year 2007 budget request. The Department continues to explore ways to deploy a regional IPLEC in Eastern Europe to coordinate intellectual property enforcement issues and build relations with foreign law enforcement.

The Department also is working to co-locate prosecutors and FBI personnel in key regions where intellectual property theft is a concern and continues to explore methods to increase the effectiveness of computer forensic methods. With respect to victim cooperation and awareness, the Department is planning two Victim Conferences in Los Angeles and New York within the next three months to promote the public-private partnership that is the key to a successful intellectual property protection program. Finally, the Department continues to develop its youth awareness program on intellectual property and has secured funding for a teacher training program and other educational events.

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Exhibit B-1: Intellectual Property Offenses Prosecuted By Districts With CHIP Units in Fiscal Year 2005

District	Defendants Charged	Cases Charged	Defendants Sentenced	No prison	1-12 months	13-24 months	25-36 months	37-60 months	60+ months
CALIFORNIA CENTRAL	39	13	23	16	5	2	0	0	0
CALIFORNIA EASTERN	2	1	1	0	0	0	0	0	1
CALIFORNIA NORTHERN	9	7	4	2	2	0	0	0	0
CALIFORNIA SOUTHERN	2	1	3	0	1	1	0	0	1
DISTRICT OF COLUMBIA	5	5	4	4	0	0	0	0	0
FLORIDA MIDDLE	4	4	8	3	2	2	0	0	1
FLORIDA SOUTHERN	11	8	6	3	1	1	1	0	0
GEORGIA NORTHERN	6	4	8	3	2	1	1	1	0
ILLINOIS NORTHERN	8	7	0	0	0	0	0	0	0
MASSACHUSETTS	0	0	1	1	0	0	0	0	0
MISSOURI WESTERN	2	2	2	1	1	0	0	0	0
NEW YORK EASTERN	5	4	9	5	1	3	0	0	0
NEW YORK SOUTHERN	69	9	6	3	0	2	1	0	0
PENNSYLVANIA WESTERN	8	7	2	0	1	0	0	1	0
TENNESSEE MIDDLE	2	1	1	1	0	0	0	0	0
TEXAS NORTHERN	0	0	3	2	0	1	0	0	0
VIRGINIA EASTERN	8	7	8	2	2	1	1	2	0
WASHINGTON WESTERN	0	0	0	0	0	0	0	0	0
CHIP UNIT TOTALS	**180**	**80**	**89**	**46**	**18**	**14**	**4**	**4**	**3**
TOTAL FOR ALL USAO DISTRICTS	**350**	**169**	**149**	**79**	**33**	**18**	**7**	**7**	**5**

Case Statistics were compiled by the Executive Office for United States Attorneys, U.S. Department of Justice. This chart includes data on any and all criminal cases/defendants where the following charges were brought as any charge against a defendant: 17 U.S.C. 1201 to 1205 (circumvention of copyright protection systems); 18 U.S.C. 1831 (economic espionage); 18 U.S.C. 1832 (theft of trade secrets); 18 U.S.C. 2318 (counterfeit labeling); 18 U.S.C. 2319 (criminal copyright infringement); 18 U.S.C. 2319A (live musical performance infringement); 18 U.S.C. 2320 (trafficking in counterfeit goods); or 47 U.S.C. 553 and 605 (signal piracy). However, the statutes were run together to eliminate any double counting of cases/defendants where more than one of the statutes was charged against the same defendant. This chart may not include criminal cases/defendants involving these offenses where the charges filed included only a conspiracy to violate any of the identified offenses. In addition, the data does not include month of September 2005 information for the Eastern District of Louisiana due to Hurricane Katrina.

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EXHIBIT A

CHIP RESOURCES - AUSA ALLOCATIONS

District	7/2001 Allocation	2002 Allocation	2004 Allocation	Matching	Total
CDCA	2		2	4	**8**
NDCA	4		1	2	**7**
SDCA	2			2	**4**
NDGA	3			1	**4**
MASS	2			2	**4**
EDNY	2			2	**4**
SDNY	3			2	**5**
NDTX	3			1	**4**
EDVA	4			2	**6**
WDWA	3			2	**5**
WDMO		2		2	**4**
NDIL		2		2	**4**
SDFL		2		2	**4**
EDCA			2		**2**
MDFL			2		**2**
WDPA			2		**2**
DDC			2		**2**
MDTN			2		**2**
	28	6	13	26	**73**

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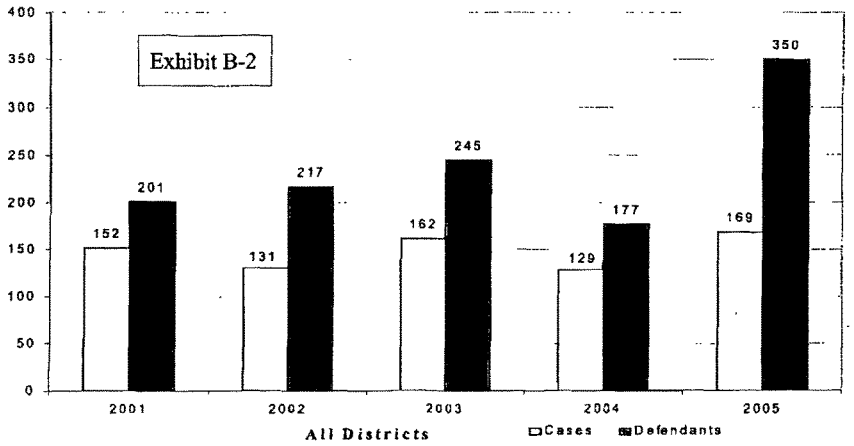
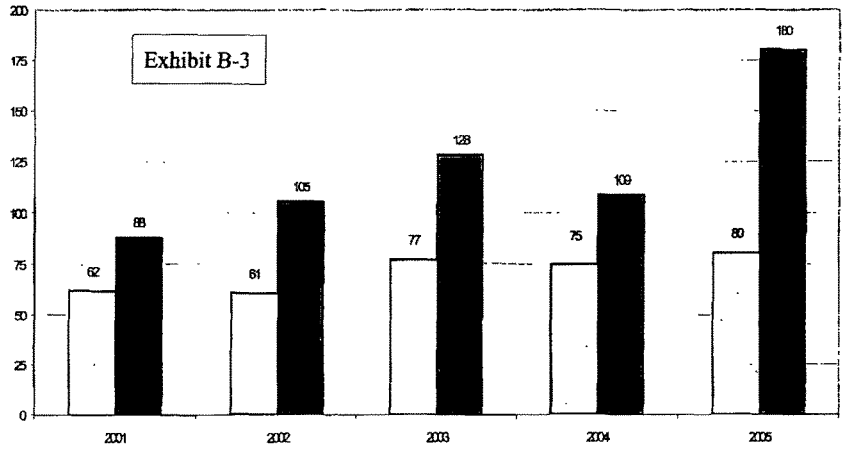
Department of Justice Intellectual Property Prosecutions in Fiscal Years 2001 - 2005





Districts With Computer Hacking & Intellectual Property (CHIP) Units

These graphs include data on any and all criminal cases/defendants where the following charges were brought as any charge against a defendant: 17 U.S.C. 1201 to 1205 (circumvention of copyright protection systems); 18 U.S.C. 1831 (economic espionage); 18 U.S.C. 1832 (theft of trade secrets); 18 U.S.C. 2318 (counterfeit labeling); 18 U.S.C. 2319 (criminal copyright infringement); 18 U.S.C. 2319A (live musical performance infringement); 18 U.S.C. 2320 (trafficking in counterfeit goods); or 47 U.S.C. 553 and 605 (signal piracy). However, the statutes were run together to eliminate any double counting of cases/defendants where more than one of the statutes was charged against the same defendant. This chart may not include criminal cases/defendants involving these offenses where the charges filed included only a conspiracy to violate any of the identified offenses. In addition, the data does not include month of September 2005 information for the Eastern District of Louisiana due to Hurricane Katrina.

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Questions Submitted by Patrick Leahy
"Protecting Copyright and Innovation in a Post-Grokster World"
October 5, 2005

Questions for Gary Shapiro:

1. We have heard a lot about filtering, especially since the Grokster decision was announced. When we say "filtering", we mean having a technology that can distinguish between digital files that copyright holders are willing to share, and those that they are not. Has anyone accomplished such filtering on a scale that would meet the demands of consumers? Is the available technology keeping pace with the demands of the law?

2. Many people treat the Grokster decision as if it ended the story on liability for inducing the infringement of copyright. The Supreme Court did write a strong opinion on the subject, but that case is back in the trial court, and there will doubtless be other cases brought. How do you see inducement liability developing in the trial courts, and what do you think the practical impact will be on consumers?

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SUBMISSIONS FOR THE RECORD

Written Testimony of Ali Aydar
Chief Operating Officer
SNOCAP, Inc.
Before the Senate Judiciary Committee
September 28, 2005

Introduction

Mr. Chairman, members of the committee, thank you for the opportunity to be here this morning. My name is Ali Aydar, and I am the Chief Operating Officer of SNOCAP. SNOCAP is a one-stop solution and technology platform for digital licensing and copyright management, designed to bring more music to more people through more channels, including authorized peer-to-peer networks that respect copyright.

Almost ten years ago, I met a teenaged computer programmer named Shawn Fanning, and six years ago, I joined him at an unknown music file sharing service called Napster. The lessons we learned at Napster shaped our vision of a flourishing digital music marketplace that we're working to enable today, one that meets the needs of copyright owners, online retailers and consumers. I appreciate this chance to share some of our thoughts with the Committee.

Lessons Learned from the Past

Napster was created by Shawn Fanning in 1999. These were the days when, for the most part, only universities and large corporations had broadband Internet access and the digital music "market" consisted of searching for links to mp3 files to download. Search engines at the time were far less advanced than they are today, and many of the links were "dead." Shawn wrote a piece of software that created a real-time list of files available to be downloaded, and sent it to a few friends. Before we knew it, the application had been downloaded by thousands of people -- and the rest is history.

At the time (and likely still today), Napster was the fastest growing Internet application of all-time. At its peak, the company had 85 million registered users and 2 million simultaneous users around the world. People everywhere loved Napster, and it wasn't just because Napster enabled free access to millions of music files. It was because Napster reconnected people with long lost music and memories, and created communities of like-minded listeners.

Aside from the individual benefits experienced by Napster users, broadband growth exploded, millions of PCs were sold with expanded hard-drives, and a struggling computer company named Apple released a pocket-sized device called the iPod on which consumers could store thousands of songs. Related to Napster or not, the growth in these areas occurred concurrently with a slump in the record industry.

Napster came a few years before its time. While consumers were clearly ready to obtain their music digitally, the recording industry and music publishers were not yet

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ready to embrace the digital channel. Despite Napster's best efforts to transition to an authorized business model, the company was forced to file for bankruptcy after nearly two years of litigation. From its ashes sprang hundreds of new P2Ps, designed specifically to skirt the law that was established in the Napster case. I'll speak more about those later.

We learned many things from our experience at Napster that stay with us to this day and inform our efforts at SNOCAP. Allow me to share a few of the things I learned.

First, as I mentioned, we learned that consumers were ready for digital music long before the recording industry was ready or even able to provide it. By the late 1990s, the Internet had become a central part of our lives, and consumers were ready to get their music through the Internet

Second, we learned that it wasn't about free, it was about having every song or symphony or speech you ever heard, no matter how exotic or obscure, at your fingertips. It was about being able to hear that music however and wherever you wanted: at your computer, in your car, on your stereo, at the beach -- an unlimited jukebox to satisfy everyone's musical tastes that couldn't be fulfilled through traditional retail channels.

Until the Internet came along, the economics of retailing and the physical space involved made it impossible to carry an unlimited inventory of less popular music. Most record store inventory was centered on the "hits" -- content that would sell more than just a few copies. In industry terms, this is known as the active catalog. The active catalog includes not only popular new content, but also older content from artists that are still popular (e.g. the Beatles, Johnny Cash, Pink Floyd, Jimi Hendrix, Barbara Streisand, Elvis Presley, and others). That left out the thousands of releases that sell only a few copies a year. In the past, labels usually removed albums that did not sell 2000 copies a year from their catalogues. While labels retain ownership of these less popular albums in most circumstances, they do not actively manufacture, distribute or promote. There are tens or hundreds of thousands of albums in this category.

Finally, we learned of the tremendous meaning music has in many people's lives. Whether it's the music you heard your parents listening to when you were a child, the first song you danced to, the hits of your high school years, your first concert, or your most recent one, music connects to our emotions, and no one other than you can decide what music is meaningful and how.

Overview of Today's Digital Music Market

Fast forward five years to today. There are hundreds of authorized outlets for digital music, and sales are growing. Around 2 million songs are now available on authorized digital retailers, and according to a study by the NPD Group in June, 2.8% of US households have downloaded paid music over the Internet. However, with more than 100 million people using unauthorized P2P services, most digital music users have come to expect access they don't get from authorized services. Over 25 million tracks are

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available on the hundreds of unauthorized networks that sprang up to skirt the case law that Napster established. For the most part, these services operate with no centralized architecture, meaning there is no switch to flip to stop them from proliferating. Additionally, subsequent generations of P2P services have gone further underground (these services are sometimes referred to as darknets).

In my opinion, increased "access" is the key to allowing the legitimate marketplace to reach its potential. The challenge is to figure out how to get more content through more channels so that music fans can legally obtain access to the same variety of music that is available to them on P2P services, while ensuring that the legitimate interests of copyright holders are protected.

Even today, significant barriers to this kind of access remain in place.

Record labels are burdened by the needs both to digitize and obtain copyright clearances for their vast back catalogs, and to develop and maintain relationships with the hundreds of retail outlets that want to sell their content online. This is a drastic change from the way business is done in the physical world, where labels have historically only dealt with a few distributors for their national and global needs.

Smaller labels and artists, which have gained some ground due to the creation of independent content aggregators, often have a difficult time getting the attention they need.

Would-be retailers of digital music face a parallel set of challenges. First and foremost, they can't offer their consumers a selection comparable to what is available on the P2P services. To do so would require the enormous effort of locating and negotiating deals with tens of thousands of copyright owners, or more.

It is inaccurate to say this is the fault of the record labels or the retailers. Today, there are literally hundreds of thousands of living copyright owners. Each on-line retailer would have to strike an enormous number of direct deals to match the number of tracks the existing P2Ps provide -- a legal, economic, and practical impossibility. This difficulty narrows consumer choice: your favorite local garage band or gospel choir is not likely to get picked up by the existing authorized services.

Without the broad selection of the unauthorized P2Ps, sales volume remains relatively low for the authorized P2Ps, which means these retailers have a difficult time sustaining their businesses. This challenge, coupled with the fact that retailers have but a few digital music business models from which to choose, make it difficult for the market to flourish.

So, fans are stuck between the limited selection of today's authorized services, and the poor user experience offered by the unauthorized P2Ps – adware, spyware, viruses, spoofed files, pornography… not to mention the fact that copyrights are not respected and users risk being sued.

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The SNOCAP Solution

SNOCAP is our effort to solve these challenges. SNOCAP is a business-to business service which fills that gap in a way that respects copyrights, vastly expands listeners' access to music, and simplifies distribution for both the rights holder and the on-line retailer.

SNOCAP is a media registry and technology platform that is open to all rightsholders, provides a mechanism for them to identify and take control of all the content they own on P2P networks, and enables a robust market that offers consumers more music through more channels.

SNOCAP acts as an honest broker in a complicated business, a one-stop clearinghouse. Copyright owners register their content with SNOCAP and set the terms of distribution, including price and format. They can make their content available for sale or block it. Retailers – including *authorized* P2P networks -- can then access content through SNOCAP rather than negotiating hundreds or thousands of separate deals, and offer the registered content to consumers.

In addition, SNOCAP uses proprietary technology to identify unregistered tracks, works being traded on P2P networks whose copyright owners are not readily apparent. SNOCAP offers rights holders the ability to register additional content they own and providing a mechanism for bringing most, if not all, of the over 25 million tracks available on P2Ps to the paid marketplace -- giving consumers the depth they're looking for and allowing profitable, legal P2P distribution in the post-*Grokster* world.

Because SNOCAP simplifies access to authorized music and the management of its distribution online, rights holders can focus on making music, assured that their rights are protected; existing retailers can decrease their operational burdens and better compete with "free"; new retailers can enter the market with innovative ideas without major barriers; and consumers enjoy a vibrant market with the broad selection they have become accustomed to, available from a variety of business models, included legitimate, authorized P2P services.

We believe it's a dramatic step forward and it's just the beginning.

As a neutral player in a dynamic market, SNOCAP can become a registry and clearinghouse for other digital content -- film, television, books, recipes, and medical information, to name but a few – that brings content creators and consumers together wherever they are. Creative people can focus on their craft, make their art available to a broad audience on whatever terms they choose, and protect their rights.

As the convergence of media and technology matures, SNOCAP will enable rights holders to efficiently move beyond the PC to new and as yet untapped channels. It allows the Internet to finally realize its most fundamental promise – a medium where the

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world's information, knowledge, art and science can be shared universally, immediately and legally.

Mr. Chairman, members of the Committee, I have been focused on these issues for the past six years. Measured against the history of the other profound issues you deal with on your committee, six years is only a blip on the radar. But in the music industry, six years is an eternity. For anyone who follows this space, it is obvious that all distribution of media is moving away from the physical and into the digital realm. Before this can happen, however, the gap between consumer demand and the authorized services available to them must be bridged. We have worked to help ensure that SNOCAP is that bridge.

Thank you for the opportunity to present our views.

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Written Statement of the Center for Democracy and Technology for Senate Judiciary Committee Hearing, "Protecting Copyright and Innovation in a Post-Grokster World" September 28, 2005

The Center for Democracy and Technology (CDT) is pleased to submit this written statement for the record of the September 28, 2005 hearing on "Protecting Copyright and Innovation in a post-Grokster World."

CDT is a nonprofit public policy organization dedicated to defending and enhancing civil liberties and democratic values on the open, decentralized Internet. CDT believes the ongoing debate about the appropriate legal and technical means to protect copyright in the digital age has significant long-term implications for the future of the Internet. CDT therefore has actively engaged in this debate, with the goal of supporting balanced approaches that can protect against copyright infringement in a manner consistent with innovation and the open architecture of the Internet. We appreciate the Committee's focus on this important set of issues, and we thank you for the opportunity to submit this statement for the record.

In the wake of the *Grokster* decision, CDT does not believe there is a current need for legislation in this area. Rather, what is called for is a combination of:

- vigorous enforcement of existing law;
- the development of a robust marketplace of legal channels for online content distribution, with appropriate content-protection technologies; and
- better public education.

This statement will discuss (1) why CDT believes it is essential to pursue a balanced approach to the problem of large-scale online copyright infringement; (2) what the basic elements of a balanced approach would be; and (3) how the *Grokster* decision fits into such an approach.

1. The Shared Interest in Developing Balanced Solutions

The Internet and digital technologies promise to greatly expand the "marketplace of ideas." They enable the delivery of new voice, video, and data content online to millions of Internet users worldwide. They also offer new and transformative uses of that content, which will promote expression, civic discourse, and economic opportunity.

Unfortunately, the technologies that can locate, deliver, and transform content are also being used for massive copyright infringement. While some have questioned the extent of the commercial impact, CDT believes that widespread infringement is a real problem. Moreover, in the absence of any sound strategy to combat piracy, the likely result is responses, including government action, that run counter to the open and decentralized nature of the Internet and could stifle innovation. Thus, while the digital copyright

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debate has been contentious and often shrill, CDT believes there is a strong shared interest in finding reasonable solutions to reduce piracy in ways that are consistent with Internet values.

Stakeholders and policymakers risk several adverse outcomes if they fail to pursue balanced approaches to the problem of widespread Internet piracy.

- First, massive infringement may continue undeterred, chilling the development of valuable and expensive-to-create content.

- Second, the government may respond to the piracy problem in ways that are in direct conflict with the innovation and openness that makes the Internet and other digital communications media so valuable. For example, government could seek to fight infringement through the imposition of burdensome technology mandates or by imposing broad liability on intermediaries or equipment makers – any of which could severely chill innovation and limit the choices available to consumers. Another possibility would be the imposition of blocking or filtering mandates on Internet service providers (ISPs) – for the first time turning ISPs into government gatekeepers responsible for what their customers do online.

- Third, copyright holders may seek to limit content delivery to closed networks or consumer electronics boxes that do not connect to the Internet. This would ignore the demand for access to content as part of consumers' increasingly integrated, multi-media, and creative experience. It also could have the practical effect of actually fueling piracy by leaving peer-to-peer (P2P) networks as the only way for consumers to get valued content on their computers.

Content creators, technology companies, and consumers all have a strong shared interest in avoiding these outcomes.

2. A Balanced Approach To Address the Piracy Problem

CDT believes there is a path towards a balanced set of solutions to the piracy issue. The solutions will not eliminate piracy completely – likely an impossible task. Rather, the goal should be to make infringement unattractive, risky, and rare.

This can be achieved through a carrot-and-stick approach: distributing digital content in ways that will attract paying customers (the carrot), while making infringement unenticing and demonstrating that bad activity will be punished (the stick). The approach should have three prongs.

- *Punishing bad actors*, whether individual infringers or companies that profit by actively encouraging infringement. CDT believes that making infringement a dangerous activity that users recognize as illegal will encourage the vast majority of law-abiding citizens to choose lawful services. Thus, lawsuits against infringers can play a positive role. Similarly, strong but carefully targeted

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penalties against companies that *intentionally encourage* infringement can deter bad business behavior without chilling innovation. As discussed below, the Supreme Court's *Grokster* decision should help point the way in this regard.

- *Encouraging a marketplace of content-protective and consumer-friendly digital rights management (DRM) tools* to allow the deployment of new models for digital distribution of content. Apple's iTunes, the Napster subscription service, and other digital media offerings show how new systems can deliver content and win customers without government-imposed technology mandates or regulatory restrictions. The policy goal should be the development of a robust content delivery market in which consumers have multiple choices, sufficient information, and in which issues relating to DRM's impact on public affairs content and privacy are fairly addressed.

- *Better public education* by trusted voices, including industry and consumer groups, speaking out against bad actors to teach the public that infringement is wrong and that illegal file-sharing is dangerous, unethical, and harmful to artists and creators. Reaching young consumers is particularly important. Consumers also will need information about DRM, so they can make informed choices and ensure a well-functioning DRM marketplace.

3. *Grokster* and Beyond

The Supreme Court's recent decision in *MGM v. Grokster* offers reason to believe that achieving a reasonable balance is possible. The case seemed to pit entertainment industry interests against many in the technology and Internet industries in a polarized, high-stakes battle. Few expected a unanimous ruling, and concurring opinions submitted by two groups of justices made clear that the members of the Court did not agree on everything. But the Court was able to find a core principle around which to build consensus. The result was a 9-0 opinion that many parties on both sides of the debate have praised.

The basic holding of *Grokster* was that P2P services can be held liable for intentionally inducing infringement through "purposeful, culpable expression and conduct." At the same time, the decision preserved the crucial legal principle – much broader than the specific P2P issues raised in the case – that a provider of technology that has lawful uses will not be held responsible simply because people use the technology for unlawful purposes. That legal principle, from the 1984 *Sony Betamax* case, has been essential to the innovation-friendly environment that has fostered the development over the last twenty years of an impressive range of technologies of great value to consumers, from the iPod to the Internet itself.

The full impact of the *Grokster* case will depend on how it is interpreted by the lower courts. Technology companies and innovators have some legitimate concerns that the decision will subject them to significant litigation risk. They fear copyright holders will try to stifle new technologies by bringing – or even just threatening – costly

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lawsuits alleging inducement. The *Grokster* opinion cited the P2P companies' failure to modify their products to reduce infringement and an advertising-based business model that profits from infringement as corroborating evidence of their intent to induce infringement. The risk to technology companies could be exacerbated if lower courts give undue weight to this language.

However, the risks to legitimate companies should be limited if lower courts follow the Supreme Court's lead in carefully targeting inducement liability at the bad behavior of bad actors, rather than at technology. The *Grokster* opinion offers plenty of guidance in this regard. For example:

- The opinion makes clear that inducement liability requires an intent to promote inducement. Mere knowledge that a product can or is being used for infringement is not sufficient.
- The opinion states that culpable intent must be demonstrated through clear expression or other affirmative acts taken to foster infringement. Thus, the focus is on the behavior of the defendant, not the capabilities of the defendant's technology.
- The opinion states explicitly that failing to make design changes to reduce infringement is not sufficient to infer culpable intent. Product design, in other words, is not a basis for liability.
- The opinion states explicitly that the fact that a company benefits financially from infringing uses of its product is not sufficient to infer culpable intent.
- The opinion states explicitly that a company's ongoing support (technical support, product updates, and so forth) of a product used to infringe copyright is not a basis for inducement liability, provided the product has lawful uses.

In short, while Congress should remain vigilant in tracking lower court interpretations of *Grokster*, the rule announced by the Court appears to leave substantial room for innovators with clean hands to develop and distribute new technologies that benefit consumers.

By confirming that operators of P2P services can be punished when they intentionally encourage unlawful activity, while preserving the pro-innovation *Sony* principle, the *Grokster* decision appears to make a significant contribution to the enforcement prong of the approach discussed in the previous section above. Enforcement tools also were bolstered by the recent enactment of the Family Entertainment and Copyright Act of 2005, which creates tough new penalties for using camcorders in movie theaters and for piracy of pre-release works.

Neither the *Grokster* decision nor other enforcement efforts, however, will eliminate the availability of infringing material on P2P networks. The specific P2P software at issue in the *Grokster* case has been distributed to millions users, and it is always possible for software developers to distribute new P2P software legally, anonymously, or from overseas. Moreover, the Internet and other digital technologies will continue to make it possible for people to engage in large-scale unlawful copying through other means.

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For that reason, it is essential to press ahead with the other two prongs of the approach outlined above: public education and, above all, the development of attractive legal online distribution services. A number of relatively new online content services have launched and proved popular with consumers. The effort to license content to legal online services must continue, and must do so in a manner that responds to the public's reasonable expectations concerning flexible uses. When legal services suffer from limitations in the availability content, or from inflexible restrictions that prevent consumers from taking full advantage of the capabilities of digital technologies, it only serves to increase the draw of illegal downloading.

Making legal content more readily available online should not require wholesale changes to copyright law or other major legislation. Rather, it requires content owners and technologists to work together toward a simple but broad goal: making virtually any content available legally, as quickly as possible, in as many forms and formats as possible, while protecting it against widespread illegal redistribution.

CDT looks forward to participating in the important ongoing policy debates concerning copyright in the digital age. We appreciate the opportunity to submit this statement.

Respectfully submitted,

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Statement of Senator John Cornyn

"Protecting Copyright and Innovation in a Post-Grokster World"
Wednesday, September 28, 2005

Mr. Chairman, I want to thank you for holding this important hearing. Like the hearing you held last week regarding the recent Supreme Court decision, *Kelo v. City of New London*, this hearing focuses on the importance of protecting property rights.

Only, this time, the property right does not involve a home – rather, it involves the property interest that artists and others have in copyrighted works. Unfortunately, every day, literally millions of dollars in copyrighted works are stolen via online services. This theft is no less wrong because it is carried out in cyberspace – rather, it is putting thousands of Americans out of work and is damaging one of the most important and vibrant sectors of the United States economy.

There is nothing wrong with the development of new and innovative technologies. To be sure, peer-to-peer technology is here to stay, and we are all the better for it. However, it is important to set the record straight about what many of these companies have done – and continue to do today – with this technology.

The Supreme Court – in a unanimous decision – made the following observations in the *MGM v. Grokster* opinion:

- "[B]ecause well over 100 million copies of the software in question are known to have been downloaded, and billions of files are shared across [respondents'] networks each month, the probable scope of copyright infringement is staggering."

- "Grokster and StreamCast are not, however, merely passive recipients of information about infringing use."

- "The record is replete with evidence that from the moment Grokster and StreamCast began to distribute their free software, each one clearly voiced the objective that recipients use it to download copyrighted works, and each took active steps to encourage infringement."

- "Three features of the evidence of intent are particularly notable. First, each of the respondents showed itself to be aiming to satisfy a known source of demand for copyright infringement, the market comprising former Napster users. Respondents' efforts to supply services to former Napster users indicate a principal, if not exclusive, intent to bring about infringement. Second, neither respondent attempted to develop filtering tools or other mechanisms to diminish the infringing activity using their software. While the Ninth Circuit treated that failure as irrelevant because respondents lacked an independent duty to monitor their users' activity, this evidence underscores their intentional facilitation of their

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> users' infringement. Third, respondents make money by selling advertising space, then by directing ads to the screens of computers employing their software. The more their software is used, the more ads are sent out and the greater the advertising revenue."

As we all know, the Court went on to hold Grokster and Streamcast liable for the resulting acts of infringement by end users – irrespective of the potential egitimate uses of their products.

Time will tell how broadly the Court's decision will be interpreted and ultimately implemented. But the decision – at a minimum – recognizes and reinforces the importance of protecting intellectual property rights and makes clear that facilitation of copyright infringement will not be tolerated.

We must continue to be vigilant in protecting these rights. I was pleased to join my colleague, Senator Feinstein, in the 108th Congress to introduce the *Artists' Rights and Theft Prevention, or "ART," Act*, which focused on the most egregious form of copyright piracy plaguing the entertainment industry – the piracy of film, movies, and other copyrighted materials ***before*** copyright owners have had the opportunity to market fully their products. With the help of Senators Hatch and Leahy, that bill became law earlier this year as part of the Family Entertainment and Copyright Act (FECA).

I am also pleased to be working with the ranking member, Senator Leahy, and other colleagues on additional legislation that will protect against rampant counterfeiting that plagues the American public and American business today. I look forward to continuing to work together to address these and other serious problems involving intellectual property.

In closing, as we consider additional legislative measures and as we observe the implications of the Court's ruling in *MGM v. Grokster*, we must ensure that the advent of the internet and the expansion of innovative technologies do not set aside the basic principles that theft is wrong… and that facilitation of theft is equally wrong.

Mr. Chairman, thank you.

Senator Dianne Feinstein

"Protecting Copyright and Innovation in a Post-Grokster World"
Senate Judiciary Committee
Opening Statement

I want to thank the Chairman for holding this hearing, and to all the witnesses, many of whom are from my home state, for coming.

This past July, the Court unanimously issued a major decision in the *MGM Studios v. Grokster* case. In that case the Court set out a new important framework which clarifies that a company may not intentionally induce illegal exchanges of copyrighted works over the Internet.

I am pleased the Committee is exploring the impact of this decision and how it is being handled throughout the various industries.

This decision has already had a significant impact on the U.S. copyright industry both on the content and the technology and innovation sides. And by impacting these industries, it will have a significant impact on California and California's economy.

All of the industries directly impacted by this decision are at home in California, and many have a significant presence:

- All of the major movie studios are headquartered in Los Angeles;
- Universal Music Group is headquarter in Santa Monica and has an almost 25% worldwide market share in 2004;
- Apple which manufactures the iPod and owns iTunes is headquartered in Cupertino;

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- Intel has been at the cutting edge of technology innovation and has its imprint on computers and digital music players throughout the world, and it is headquartered in Santa Clara;

- Napster now has extensive content agreements with the five major record labels, as well as hundreds of independents and has offices in Los Angeles and San Diego; and

- Yahoo! is headquartered in Sunnyvale, California. Yahoo! has led the way in information sharing, communication, internet shopping, and has recently expanded to Y! Music which provides music tracks for purchase

And that's just the tip of the iceberg. All of these industries are important and essential for growth.

The Motion Picture Association of America has estimated the film industry loses around $3 billion each year, and the recording industry has estimated that it has lost almost $5 billion annually due to online theft and illegal file-sharing.

However, the technology industry has expressed its concerns over proposals that have sought to protect content but may have had an inadvertent effect of stifling innovation.

I am pleased that the Supreme Court has decided the *Grokster* case, and I hope it will prove to have struck the right balance between these important industries.

I understand the Recording Industry is working with at least five file-sharing services to convert free trading of copyrighted music on their networks to paid services, however, I have also read press reports that the "P2P" user volume has continued to increase even after the decision.

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I look forward to hearing the witnesses' testimony and learning more about how changes are being implemented, as well as what is and isn't working.

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Statement of Senator Patrick Leahy
Ranking Member, Committee on the Judiciary
Hearing on "Protecting Copyright and Innovation in a Post-*Grokster* World"
September 28, 2005

Peer-to-peer technology has revolutionized the way people share all sorts of information. But as with any technology, it can be abused, and unfortunately, it has been. And as with any technology, those who abuse it effectively prevent that technology from reaching its highest potential. More than two years ago, the Judiciary Committee held its first hearing on peer-to-peer, beginning an important dialogue with many relevant communities about copyright issues in the peer-to-peer context. I have always been a champion of innovation, and have long deplored the fact that a few rogue peer-to-peer companies have hijacked the enormous potential of this technology.

I have high hopes -- as someone who loves music, as someone who is fascinated by technology, and as someone who represents a state full of other music and technology fans – that the emerging market for legitimate online music sales will prosper. And I hope it will do so quickly.

My concern is that, unless the problems of piracy and privacy are addressed, peer-to-peer will never realize its enormous potential to build online communities, to enhance networked learning, and to make unprecedented amounts of material, both educational and entertaining, available world wide. I remain concerned about the privacy and security issues, but since the Supreme Court's decision in the *MGM v. Grokster* case, the industry players have certainly had an incentive to find ways to provide online music without promoting the theft of music online.

Last June, in *MGM v. Grokster*, the Supreme Court unanimously held that someone who distributes a device, with the purpose of promoting its use for infringing copyrights, will be just as liable for the infringement as the third parties who do the direct infringing. The Court emphasized that Grokster's unlawful purpose was abundantly obvious, and declared that courts considering such cases must look at just such facts in trying to determine the objectives of defendants.

We should all remember that it is people – people using technology – who infringe copyrights. Technology itself is not the problem, and neither is technology alone the solution. Our goal must be the responsible use of technology, and the respectful treatment of intellectual property rights. Our technologies may evolve, but the central principles of respect for rights and promotion of innovation should remain constant. The balance between these is critical to maintaining our nation's status as the world leader in

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intellectual property. We have all heard a great deal about peer-to-peer networks; now we are hearing more about webcasting and satellite radio. We all want consumers to enjoy the great diversity of music available, and we must ensure that they do so legally.

I thank the witnesses who are here to herald a new beginning in the world of online music, and I look forward to hearing how they see that world.

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Protecting Copyright and Innovation in a Post-Grokster World

Testimony Before the Senate Committee on the Judiciary
September 28, 2005

Professor Mark A. Lemley, Stanford Law School[1]

The Need for Balance

Copyright owners fund the creation and distribution of new works of art, music and literature that make the world a better place. Copyright owners are rightly concerned with infringement in the digital environment. In the past ten years, Congress has created a wide variety of regulations designed to help solve this problem. Those laws have helped, and yet the problem remains. Copyright owners accordingly want Congress to do still more to help them reduce copyright infringement.

Technology companies create innovative products that make the world a better place and drive a significant fraction of the U.S. economy. Unlike copyright owners, they have not regularly sought help from Congress. Instead, they for the most part want to be left alone to innovate and sell products.

Unfortunately, those interests increasingly come into conflict. Copyright owners increasingly sue not the people who actually engage in infringement, but who provide goods or services that can be used by others to infringe. They have cast their net ever wider in their effort to stop infringement, suing not only those who provide services directly connected to infringement, like Napster, but makers of consumer electronics devices that play music, sellers of software that can be used to infringe, Internet service providers, search engines, telephone companies who own the wires, venture capitalists who fund companies that do these things, and even law firms that advise them.

Copyright owners are attracted to suing these intermediaries because it is cheaper and easier than suing the millions of American consumers who download music without paying. But doing so comes at a cost. If writing software, or making a consumer electronics device, or running a search engine, can subject someone to statutory damages that can run into the billions of dollars, or perhaps even criminal liability, innovators and entrepreneurs will think twice before developing or marketing a new product that might subject them to a lawsuit. And since the courts have interpreted copyright law not to have any corporate veil, someone who runs or simply works for such a company could lose their house and their family's retirement fund. The threat of a lawsuit will deter not just innovators developing technologies with illegal uses, but those who develop technologies with both legal and illegal uses and those who don't yet know how the market will use their technology. The list of such dual-use technologies is long and

[1] Because I have represent clients in digital copyright cases, including Grokster, I wish to make it entirely clear that the views I express here today are my own, and not those of my clients.

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distinguished: broadband Internet service, the iPod, TiVo, CD burners, and computers themselves, to name just a few.

While reducing copyright infringement is an important goal, it cannot and should not be the only goal of public policy. Congress should also be concerned that overzealous enforcement of copyright will create a hostile environment for technological innovation and entrepreneurial business models. It should strive to balance these important interests, providing effective copyright protection but also preserving an environment in which innovation can thrive.

Nor can Congress simply rely on assurances from the copyright industry that they will foster innovation themselves, or target only "bad" and not "good" innovations. The content industry has proven short-sighted, time and again trying to stifle technologies that ultimately proved beneficial not only to society but even to copyright owners. They tried – and fortunately failed – to shut down jukeboxes, radio, cable television, the VCR, and the mp3 player. Perhaps it should not surprise us that publicly traded companies should have a short-run focus, looking at this quarter's bottom line and not what will benefit society in the long run.

Further, the content industry is not monolithic. Innovators need to worry not just about what the major music and movie studios will do, but also what a variety of fringe content owners and tens of thousands of writers will decide to do. Many of the cases that demonstrate the worst overreaching – suits against search engines, for example – are brought not by the major studios but by pornographers or idiosyncratic individuals. If copyright law gives those individuals the power to stop innovation or to control its direction, new technologies will exist only if all of those thousands of content owners sign on. The difficulties legal music services such as iTunes have faced in trying to clear all the necessary licenses for content are but one example of the problems that broader copyright protections can create.

The Uncertain Impact of Grokster

The legislative landscape changed significantly in June, when the Supreme Court decided *MGM v. Grokster*. In that case, the Court created a new cause of action for inducement of copyright infringement previously unknown in copyright law. In doing so, the Court sought to hold liable particular peer-to-peer (p2p) software providers that it viewed as bad actors without exposing the entire technology industry to the debilitating risk of liability that would come from abandoning or limiting the *Sony* safe harbor for devices capable of a "substantial noninfringing use." In short, it sought to achieve the balance I have just described.

Whether the Court succeeded in creating a middle ground remains to be seen. Much will depend on how the Court's open-ended, multi-factor test for improper purpose is interpreted in the lower courts. Much will also depend on how far copyright owners seek to take the new doctrine, and whether they overreach. For this reason, it is premature to propose legislation to correct deficiencies in the new inducement test.

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Nonetheless, three questions left open by the *Grokster* opinion bear close scrutiny, and may ultimately require correction or clarification by Congress.

1) *What is required to prove improper purpose?* The *Grokster* opinion found evidence of bad intent on the basis of allegations[2] that the p2p defendants were founded in order to reach former Napster users, most of whom were engaged in copyright infringement; that the defendants did not redesign their software to minimize infringement; and that the defendants, like most companies, made more money the more users they had, and therefore had a motivation to permit or encourage infringement. A narrow reading of the Court's opinion would require the confluence of all or almost all the factors at issue in *Grokster*. On this view, only a company whose business model was designed to promote infringement need worry about inducement liability.

By contrast, a broad reading might find liability based on some subset of the three, such as making money from software knowing it was used by infringers.[3] If courts do read *Grokster* so broadly, it would create real problems for legitimate technology companies, many of whom could be threatened with suit on the basis of conduct that is as consistent with legitimate as with wrongful intent. Should that happen, Congress may need to intervene in order to protect innovation.

2) *What conduct is required?* The *Grokster* opinion focused its primary attention on the question of the p2p defendants' purpose. It finessed the question of what *conduct* must be coupled with an improper purpose in order to find infringement. At various points, the Court made it clear that to be liable for inducement a defendant must do more than simply sell a product capable of both legal and illegal uses with bad intent. It recited conduct it believed the defendants had engaged in, including advertisements allegedly targeting infringers and the provision of tech support to people who were infringing. The requirement for some affirmative conduct that *induces* (ie. causes) infringement by others follows naturally from the patent standard, which clearly requires affirmative conduct beyond simply the sale of a product. [See my draft article, "Inducing Patent Infringement," attached]. And since the Court unanimously reaffirmed the *Sony* "safe harbor" in footnote 12, it would make little sense to interpret the new inducement test in a way that would effectively overrule *Sony*.

But at other points in the Court's opinion, the Court suggested that the sale of a lawful product standing alone might suffice to prove inducement if were coupled with bad intent. If courts read *Grokster* to cover sales alone, they will doom any innovator to the risk of liability whenever a plaintiff can find a memorandum from the marketing department or conduct by tech support staff that could support a finding of bad purpose.

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[2] Because inducement was not litigated in the courts below, the defendants had no opportunity to contest the evidence and arguments made by the content industries on this question. Thus, whether the defendants actually violated the new inducement standard must await further factual development in the district court.

[3] The Court made it clear that neither failure to modify software nor the making of money standing alone would be sufficient to find inducement. But targeting illegal users, or some combination of two factors, might be.

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No matter how valuable the product, the technology company would risk a lawsuit if any copyright owner decided it wanted to sue. Should courts take this route, Congress may need to intervene in order to protect legitimate technology companies.

3) *What state of mind must exist regarding infringement?* The final question is what a defendant must intend – merely the acts they encourage, or actually to promote infringement? The question didn't arise for the Court in *Grokster* because it seemed clear that p2p file sharers were in fact infringing. But in other circumstances, companies will intend to encourage copying but believe that that copying is legal, for example because it is a fair use or has been authorized by the copyright owner.

In such circumstances, it would not make sense to hold the company liable. As Jonathan Band writes in the Computer and Information Lawyer:

> Thus, it is unlikely that a person can be liable for inducement if he advertises a use that he reasonably believes to be a fair use, but which turns out to be an infringement. The language of the opinion suggests that liability should attach only if the defendant had the specific intent to cause infringement: "the object of promoting its use to infringe," *id.* at 2770, "their principal object was use of their software to download copyrighted works," *id.* at 2774, "an actual purpose to cause infringing use," *id.* at 2778, "statements or actions directed to promoting infringement," *id.* at 2779, "purposeful, culpable expression and conduct," *id.* at 2780, "a message designed to stimulate others to commit violations," *id.*, "acted with a purpose to cause copyright violations," *id.* at 2781, "a principal, if not exclusive, intent on the part of each to bring about infringement," *id.*, "intentional facilitation of their users' infringement," *id.*, "unlawful objective," *id.*, "the distributor intended and encouraged the product to be used to infringe," *id.* at 2782, n.13, "a purpose to cause and profit from third-party acts of copyright infringement," *id.* at 2782, and "patently illegal objective." *Id.*

Further, as I explain in my attached article on inducing patent infringement, the majority view of the courts in patent law requires intention to cause another to infringe, not simply intention to cause copying that might or might not be infringement. It seems logical to understand copyright law the same way, since *Grokster* created copyright inducement from the patent analogy.

If the courts get this wrong – if they interpret *Grokster* to make illegal any intent to encourage copying, even if the defendant believes that copying to be legal – the consequences for companies like search engines could be significant. In that case, Congress may need to intervene in order to protect innovation.

The Problem Won't Go Away Because of *Grokster*

The above comments make it clear that *Grokster* is not a perfect solution for technology companies. Interpreted narrowly, to cover only businesses purposefully built on supporting infringement, it is a rule that most technology companies can live with.

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But if copyright owners try to expand the reach of the opinion they will create an environment in which innovation is difficult if not impossible.

Nor is *Grokster* a panacea for the copyright owners. While it provides a new legal tool they can use against some p2p companies, it will not eliminate copyright infringement in the digital environment. It won't eliminate p2p file sharing, and indeed the Supreme Court was careful to note that p2p technology itself was a good thing. Nor can inducement liability be used against infringement through decentralized software systems not run by a company that can be found liable for inducement.

As a result, neither the problem of copyright infringement nor the threat to innovation posed by overzealous copyright enforcement will go away. Congress and the courts will have to continue to try to solve one problem without making the other worse.

Possible Legislation

While in my view it is too soon to propose legislation dealing with *Grokster*'s new inducement standard, there are a number of things Congress might do to help ease the burdens the current situation places both upon copyright owners and innovators.

1) *Make it easier for copyright owners to target direct infringers.* Part of the reason copyright owners target intermediaries and innovators is that they find it difficult to find and target the people who are actually doing the infringing. Anything Congress can do to help stop the direct infringement will relieve the pressure on innovators. In an article published earlier this year entitled "A Quick and Inexpensive System for Resolving P2P Copyright Disputes," Tony Reese and I propose to use the Copyright Royalty Judges Congress created last year to administer a quick, simple and cheap system for identifying and punishing high-volume illegal file traders. [A copy of the article, including proposed legislation, is attached]. If copyright owners have an effective way of targeting direct infringers, they will have less desire or inclination to go after intermediaries in a way that threatens innovation.

2) *Make it easier to clear rights in the digital environment.* Consumers want online music and other content. The unwillingness of copyright owners to fill that need in the late 1990s and the early part of this decade contributed to the problem of rampant copyright infringement. Conversely, copyright enforcement will not be effective unless it is coupled with a cheap, easy, legal alternative. While third parties like Apple have made significant strides in the last two years in putting legal music online, they are hampered by divided ownership of rights and a labrynthine set of rules that make it difficult even for people who want to make content available online to do so. Congress has begun considering how to simplify these rules. I urge you to continue this effort, and to resist efforts by special interests to complicate the ownership or licensing rules in order to protect their historic piece of the pie.

3) *Insulate technology companies from unreasonable liability.* The remedies currently provided in copyright law are written with direct infringers in mind. They

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provide a windfall to copyright owners in order to deter infringement by providing statutory damages and even criminal liability. Those remedies make sense when applied to direct infringers. They make considerably less sense when applied to companies that are not themselves infringing copyright, but merely providing a product or service that others can misuse. This is particularly true in the digital environment, since because of an accident in the way statutory damages are calculated anyone who is found liable for indirect infringement on the Internet faces liability of billions of dollars. If you are at risk of losing your whole company (and your house and your kids' education), even a very small chance of liability will be enough to deter valuable innovation.

Congress could relieve much of the pressure copyright law puts on innovation by limiting liability for indirect infringement to the actual damages caused by any such infringement. This would compensate copyright owners for their losses, and force indirect infringers to bear the cost of any harm their conduct causes, but would not over-deter innovation. And since copyright owners could still sue direct infringers for statutory damages, deterrence of infringement would remain intact.

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STATEMENT OF MARYBETH PETERS
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Before the

UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY

109th Congress, 1st Session
September 28, 2005

Chairman Specter, Senator Leahy, and distinguished members of the Committee, thank you for the opportunity to appear before you to testify on protecting copyright and innovation in a post-*Grokster* world. The Supreme Court's recent ruling in *Metro-Goldwyn-Mayer Studios v. Grokster* was one of the most significant developments in copyright law in the past twenty years. While technological progress can bring societal advances, it can also beget legal quagmires, as the emergence of online music distribution demonstrated. In its ruling in *Grokster*, the Court clarified that those who offer products and services in a way that induces others to engage in copyright infringement can be held secondarily liable for that infringement. By establishing these boundaries, the *Grokster* ruling appears to have encouraged productive negotiations and agreements within the music industry, ultimately benefitting the music consumer by making it easier to legitimately obtain music online. Subsequent U.S. and foreign court decisions demonstrate a growing acceptance of the *Grokster* ruling that those who induce infringement can be held responsible for what they have unleashed. This high-profile case also helped to raise the public

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consciousness as to the legal status of unauthorized peer-to-peer file-sharing of copyrighted works. Coupled with the increasing availability of legitimate online music services, we can hope that this will lead to a decline in illegal file sharing.

Although the *Grokster* decision contributed immensely to the world of legitimate online music distribution, it did not, and could not, resolve all of the difficulties facing this industry. One area which poses the most hurdles to efficient and affordable distribution is the process of licensing the underlying musical works. Because this process is constrained by practical and statutory antiquities, it creates an incentive and opportunity for piracy to flourish. I commend you for considering the necessity of legislation in the wake of *Grokster*, and I would suggest that the one topic on which legislation should be presently considered is the reform of the process for licensing online distribution of musical works.

The *Grokster* Decision

Given the amount of publicity *Metro-Goldwyn-Mayer Studios v. Grokster*[1] has received, a very brief and simplified recounting of its facts seems sufficient. Defendants Grokster, Ltd. ("Grokster") and StreamCast Networks, Inc. ("StreamCast") distributed software that permitted computer users to share electronic files through peer-to-peer networks. The Plaintiffs, who included all of the major movie studios and record companies as well as a large number of music publishers and songwriters, claimed not only that the software enabled the unauthorized transfer of copyrighted works such as

[1] No. 04-480, slip. op. (U.S. June 27, 2005), *available at* http://www.supremecourtus.gov/opinions/04pdf/04-480.pdf; 2005 U.S. LEXIS 5212; 545 U.S. __, 125 S. Ct. 2764 (2005).

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movies and music, but that the Defendants intended, promoted and profited from these very acts of infringement. Therefore, they argued, the Defendants should be able held secondarily liable for the direct infringement of the copyrighted works by their users.

Although the technology at issue could facilitate the transfer of any type of electronic file, the Plaintiff copyright owners presented evidence that users of the Defendants' software did in fact use it predominantly and illegally to distribute copyrighted works, without authorization from the copyright owners and without remunerating them. The copyright owners also presented evidence of the Defendants' active steps to encourage this massive infringement as well as the dependancy of the Defendants' business models on such infringement.

The district court granted summary judgment for the Defendants, finding that no secondary liability could attach where the Defendants did not have actual knowledge of specific acts of infringement.[2] The Ninth Circuit affirmed,[3] based predominantly on its misreading of *Sony Corp. of Am. v. Universal City Studios, Inc.*[4] In *Sony*, the Court ruled that the manufacturer of a VCR could not be faulted solely on the basis of its distribution of its product, even if some consumers used the product to infringe copyrights, because the VCR was capable of commercially significant noninfringing uses. The Ninth Circuit erroneously interpreted *Sony* to mean that contributory liability could not attach if a product had *any* substantial noninfringing use and the producer did

[2] 259 F. Supp. 2d 1029 (C.D. Cal. 2003).

[3] 380 F.3d 1154 (9th Cir. 2004).

[4] 464 U.S. 417 (1984).

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not have specific knowledge of the infringement at a time at which it contributed to the infringement, regardless of any intent to promote infringement which might be imputed from the producer's actions or the attendant circumstances.

The Supreme Court's ruling, though, made it clear that one who offers a product designed to infringe could indeed be held liable for copyright infringement under a theory of secondary liability. Prior to *Grokster*, the availability of secondary liability under such circumstances was a source of confusion and hotly debated. The Court settled that issue by stating, "We hold that one who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties."[5]

Besides clarifying that such liability is appropriate, the Court also explained that courts may consider all relevant factors and circumstances when evaluating whether or not to impose this type of liability. The Court gave examples of certain factors that a court might choose to consider, but it did not exclude any individual item or category of evidence. Finally, the Court preserved the holding of *Sony*, which the Court's grant of *certiorari* had led some to fear would be eviscerated, threatening to incapacitate the technology industry.

[5] Slip op. at 1.

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However, although the Court did not disturb its *Sony* ruling, it did not address a key issue that was presented to it: the scope of, in the Court's words, "the *Sony* rule and, in particular, what it means for a product to be 'capable of commercially significant noninfringing uses.'"[6] Instead, the Court stated, "because we find below that it was error to grant summary judgment to the companies on MGM's inducement claim, we do not revisit *Sony* further, as MGM requests, to add a more quantified description of the point of balance between protection and commerce when liability rests solely on distribution with knowledge that unlawful use will occur. It is enough to note that the Ninth Circuit's judgment rested on an erroneous understanding of *Sony* and to leave further consideration of the *Sony* rule for a day when that may be required."[7] And in separate concurrences, Justices Ginsburg and Breyer (each joined by two additional justices) articulated very different views as to the scope of the "*Sony* rule" and how it ought to be applied to the facts of *Grokster.*

Although *Grokster* arose in the context of the movie and recording industries' dispute with a particular technology, its implications reach much further. The theory of secondary liability for the inducement of infringement can apply to the unauthorized use of any creative work, not just music or movies. The Court's forethought in not excluding any category of evidence from the determination of liability means that the holding is sufficiently flexible to withstand the test of time and evolution of technology. Ultimately, the copyright law is better able today to address widespread infringement and provide a

[6] Slip op. at 15.

[7] Slip op. at 17.

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level playing field for all – authors, copyright owners and legitimate services and users – than it was a year ago. Authors and copyright owners can rely upon an express inducement of infringement theory of liability, legitimate services can obtain some relief from unfair competition from unlawful services that offer copyrighted works for free, and would-be defendants who might have once cavalierly hid behind what they thought was an impenetrable shield of *Sony* will be forced to evaluate their developing products more carefully.

Recognizing the broad influence this case would have on numerous industry sectors, the Justice Department submitted an *amicus* brief to the Supreme Court urging reversal of the Ninth Circuit's decision. This brief argued, in part, for a clear statement that secondary liability is appropriate for the inducement of copyright infringement.[8] The Copyright Office not only actively participated in the formulation of the Government's position, but was a signatory to the brief. I am pleased that the Supreme Court adopted many of the views and analysis set forth in the Government's brief.

The Aftermath

Just three months after the Supreme Court's ruling, it may be premature to predict what permanent effects *Grokster* will have. Initial indications are that it could have many positive ones. However, much of the Copyright Office's knowledge on the practical impact thus far has been garnered from the popular press. We are very much interested to hear what industry representatives testifying today have to say about how this case has actually affected their operations. I can also state that internationally, the

[8] The brief is available on the Copyright Office's website at http://www.copyright.gov/docs/mgm/mgm-grokster-brf-04-480.pdf.

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Grokster decision promises to be very helpful in our efforts to combat online piracy throughout the world.

Grokster coincides with, and in some cases precedes, a surge in negotiations, agreements and launchings of new legitimate online music services or supporting technologies. For example, Yahoo! recently launched its Yahoo! Music Unlimited subscription service.[9] Mashboxx is beta testing its new peer-to-peer service which will compensate copyright owners for their works. Two days after the Court ruled in *Grokster*, Mashboxx announced a license agreement it had entered into with Sony BMG Music Entertainment.[10] iMesh, another peer-to-peer service, states on its website, "In an effort to create and promote a legal file sharing Internet environment, we are entering into distribution agreements with copyright holders."[11] iTunes of course continues to flourish.

Ironically, it appears that some parties who used to be at cross purposes are now becoming partners. SNOCAP, founded by one of the creators of the infamous Napster, has entered into agreements with Sony BMG Music Entertainment, Universal Music Group, EMI Music and various independent record labels to provide copyright management technologies and database services to enable the online distribution of the copyright holders' music catalogs though authorized peer-to-peer services and

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[9] See http://music.yahoo.com/musicengine/.

[10] *Mashboxx, The First P2P Authorized by Major Record Label, Completes Licensing Deal with Sony BMG Music Entertainment* (June 29, 2005), *available at* http://www.mashboxx.com/release.html.

[11] See the *About Us* page on iMesh's website, *available at* http://www.imesh.com/about_us.shtml (last visited Sept. 25, 2005).

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online retailers.[12] Meanwhile, the copyright-supportive Mashboxx is reportedly in discussions to acquire Grokster, whose former CEO is coincidentally Mashboxx's current CEO.[13] The Court's decision in *Grokster* is likely to encourage further constructive and conciliatory measures from those who might once have ignored copyright owners' demands that they respect copyrights.

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[12] See SNOCAP, Inc.'s press releases, *available at* http://www.snocap.com/press/ (last visited Sept. 25, 2005).

[13] Reuters, *Snocap Signs Deals with Indie Labels*, NYTimes.com (Sept. 23, 2005), *available at* http://www.nytimes.com/reuters/business/business-media-snocap.html; Eric Hellweg, *Waiting for Grokster*, Technology Review.com (June 3, 2005), *available at* http://www.technologyreview.com/articles/05/06/wo/wo_060305hellweg.0.asp.

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Additionally, copyright owners seem to have become more assertive in protecting their rights since the June ruling. Just last week, the International Federation of the Phonographic Industry ("IFPI") and the Motion Picture Association of America ("MPAA") released Digital File Check, a free software program that parents, employers or others in Europe can use to uninstall or disable illegal file-sharing programs and to remove unauthorized music and movies on computers within their control.[14] The press has given much attention this month to the cease and desist letters the RIAA apparently sent to prominent illegal peer-to-peer services. I am not in a position to judge whether these tactics are working. However, I would note that there are reports that some illegitimate or questionable services have simply closed their doors, although it is possible that they will reemerge in some other location or incarnation.[15]

It is tempting to say that there must be a causal relationship between *Grokster* and all this activity. By articulating some boundaries on the development of products

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[14] Alorie Gilbert, *Record Labels Tout Program to Disable Swapping*, NYTimes.com (Sept. 22, 2005), *available at* http://www.nytimes.com/cnet/CNET_2100-1027_3-5876687.html. For IFPI's announcement, see *Music, Film Industries Team up to Help Internet Users Stay Safe and Legal, available at* http://www.ifpi.org/site-content/press/20050922.html.

[15] Andrew Orlowski, *WinMX and eDonkey: Offline, Doors Closed*, The Register (Sept. 22, 2005), *available at* http://www.theregister.co.uk/2005/09/22/p2p_networks_darken/; Thomas Mennecke, *WinMX PNP Network Mysteriously Ends Operations*, Slyck.com (Sept. 21, 2005), *available at* http://www.slyck.com/news.php?story=921; *P2P Companies to Exit Business*, DRM Watch (Sept. 22, 2005), *available at* http://www.drmwatch.com/ocr/article.php/3550721.

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used to infringe copyrights, the *Grokster* ruling may have helped to frame these negotiations and agreements. Presumably some actors who felt that the prior state of law gave them complete freedom to offer products designed to facilitate infringement - and to do so with impunity – are now having second thoughts in light of the fact that the Court has clarified that there is a basis for holding them accountable for the consequences of what they purvey. However, at this early stage, it is mere speculation to say whether these business decisions were driven by *Grokster* or were simply a determination that in order to enter or solidify their positions in the marketplace, emerging technologies needed to partner with the established music industry. Regardless of the impetus, I am encouraged by the current climate, as it is steadily providing more opportunities for consumers to enjoy music in a manner that appropriately compensates copyright owners, and creating a level playing field among all competing online music services, such as the new Napster, iTunes, Rhapsody, and others, who no longer have to compete with rogue services like Grokster whose incorrect interpretation of the law actually discouraged the building of legitimate entertainment services that respect copyright and try to minimize infringing activity.

Moreover, the sharp divisions in the Court over precisely how to interpret the "*Sony* rule" may have a salutary effect of causing developers of technology to take steps to ensure that their products and services truly have substantial noninfringing uses and are not used primarily as infringement tools. While we were hopeful that the Court's ruling would add clarity to this area of the law, it may be that the lack of clarity causes more socially responsible behavior by those who previously might have been tempted to rely on what they perceived as a "bright-line test" that absolved technology

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providers from any responsibility whatsoever for the uses to which their offerings are put.

Not surprisingly, the lower courts have begun incorporating the *Grokster* ruling into their decisions, although thus far that case law is sparse. In *MEMC Elec. Materials v. Mitsubishi Materials Silicon Corp.*,[16] the Federal Circuit applied *Grokster* in a patent context. Although a well-developed body of law provides guidance on the Patent Act's express cause of action for active inducement of infringement, set forth in section 271(b), the court specifically looked to *Grokster's* analysis of the evidence of active steps taken to encourage direct infringement, particularly a defendant's "instructing how to engage in an infringing use." The court concluded that genuine issues of material fact existed as to the subject inducement claim based on the defendant's knowledge of the patent, knowledge of the potentially infringing activity and the substantial product and technical support it provided to the alleged direct infringer. Similarly, although *Monotype Imaging, Inc. v. Bitstream, Inc.*[17] ultimately found that the defendant had not intentionally induced copyright infringement, it appropriately incorporated the *Grokster* decision into its reasoning.

While a U.S. Supreme Court decision of course has no binding precedential value outside of this country's borders, it is probably no coincidence that since *Grokster*, three courts spanning the globe have reached results consistent with the result in *Grokster.* In Australia, the Federal Court ruled this month that Sharman Networks and

[16] Nos. 04-1396, 04-1513, 2005 U.S. App. LEXIS 17956 (Fed. Cir. Aug. 22, 2005).

[17] 376 F. Supp. 2d 877, 888-889 (N.D. Ill. 2005).

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its principals are liable for copyright infringement based on the unauthorized peer-to-peer file sharing that its Kazaa application enables.[18] Although the Australian court noted that there were substantial factual and legal differences between *Grokster* and the case before it, it found liability against Sharman and Kazaa for reasons very similar to the U.S. Supreme Court's rationale, noting, for example, that:

> (i) Sharman's website promotion of KMD as a file-sharing facility . . . ;
> (ii) Sharman's exhortations to users to use this facility and share their files . . .; [and]
> (iii) Sharman's promotion of the "Join the Revolution" movement, which is based on file-sharing, especially of music, and which scorns the attitude of record and movie companies in relation to their copyright works . . . . Especially to a young audience, the "Join the Revolution" website material would have conveyed the idea that it was "cool" to defy the record companies and their stuffy reliance on their copyrights.

[18] *Universal Music Australia Pty. Ltd. v. Sharman License Holdings Ltd.*, [2005] FCA 1242 (5 Sept. 2005), *available at* http://www.austlii.edu.au/au/cases/cth/federal_ct/2005/1242.rtf.

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This focus on "positive acts by Sharman that would have had the effect of encouraging copyright infringement" is consistent with the *Groskter* Court's discussion of marketing material and other overt acts that encourage infringement. The Australian court banned the file sharing system until the defendants modify the software to include filtering technology that would exclude copyrighted works from searches. Similarly, a Korean court essentially ordered the complete shut-down of Soribada, a free Internet file trading services, and its CEO has now been indicted for copyright infringement.[19] An earlier ruling had found that the Soribada website encouraged users to commit copyright infringement.[20] A Taiwanese court has also fined and sentenced to jail several executives and a prolific user of Taiwan's largest music file-swapping Internet site, Kuro, after it found that the peer-to-peer interface violated copyright laws.[21] As the IFPI stated, "All four [cases] - including [the Taiwanese ruling,] the ruling against Kazaa in Australia, the unanimous US Supreme Court ruling against Grokster, and then the injunction against Soribada in Korea - establish there is no defence for file-sharing services that build their businesses on the back of unauthorised trading of copyrighted material."[22]

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[19] Kim Tong-hyung, *Court Blocks Free File-Sharing Service*, The Korea Times (Aug. 31, 2005), *available at* http://times.hankooki.com/lpage/nation/200508/kt2005083117362711960.htm; p2pnet, *Soribada CEO Indicted*, p2pnet.net (Sept. 8, 2005), *available at* http://p2pnet.net/story/6180.

[20] *Korean P2P Developers Free, Site Shut Down*, Digital Media News (Jan. 13, 2005), *available at* http://www.digitalmusicnews.com/results?title=Soribada.

[21] *Kuro Conviction Threaten P2P, Media Pirates*, Taiwan News (Sept. 25, 2005), *available at* http://www.etaiwannews.com/Taiwan/Society/2005/09/10/1126320681.htm.

[22] *IFPI Welcomes Landmark Conviction of Taiwan File-Sharing Service Kuro*, IFPI's website (Sept. 9, 2005), *available at* http://www.ifpi.org/site-content/press/20050909.html (last visited Sept. 25, 2005).

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In fact, the *Grokster* decision should be very helpful to the United States as it continues its discussions with other countries about bringing their copyright laws up to date to meet the challenges of the digital networked environment that connects people around the world. Peer-to-peer infringement is not just a problem in the United States; it is a major problem abroad as well. In fact, to the extent that the *Grokster* decision provides new legal tools to stop massive peer-to-peer infringement, those tools will be of limited use if unlawful peer-to-peer services simply relocate abroad to jurisdictions where United States law has no applicability and local laws do not reach such conduct. The *Grokster* decision will assist us greatly in explaining how rules of secondary liability can play a key role in combatting massive peer-to-peer infringement. In fact, if our Supreme Court had upheld the lower courts' rulings of no liability, it likely would have made our task immeasurably more difficult: how could we urge other countries to take action if our own legal system is not up to the task?

A beneficial side effect of the publicity given to the *Grokster* decision is that it has helped to bring the issue of illegal file sharing to public consciousness and made it much more difficult for defenders of the practice to claim that it is lawful. After the Ninth Circuit ruled that Grokster and StreamCast could not be held secondarily liable copyright infringement, Streamcast's website for its Morpheus file-sharing software featured the following statement: "Morpheus is the only American P2P File Sharing software ruled legal by the US Federal Courts."[23] Presumably many of Streamcast's customers interpreted that statement to mean that it was legal for them to use

[23] See the Morpheus website, www.morpheus.com, as of November 29, 2004, *available at* http://web.archive.org/web/20041129092019/http://www.morpheus.com/.

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Streamcast's file-sharing software to download and make available copyrighted music and movies without the copyright owner's authorization. As defenders of unauthorized file-sharing of copyrighted works argued that the practice was lawful and as the law seemingly provided no effective remedy against the practice, members of the public could be excused for being unclear about the legal status of unauthorized file-sharing. While *Grokster* did not directly address first party liability of the person actually engaging in the file sharing, the Court's decision and the media attention it has garnered mean that no member of the public can reasonably make the argument that he or she is unaware that unauthorized file sharing is illegal. As I stated in my testimony before the Subcommittee on Intellectual Property in July, I believe that the majority of consumers who have engaged in illegal peer-to-peer "file-sharing" of music would choose to use a legal service if it could offer a comparable product, and more fundamentally, if they knew which services were legal. The recent Supreme Court decision in *Grokster* affords legitimate music services an opportunity to make great strides in further educating the public and penetrating the market.

A Need for Legislation?

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At this time last year, this Committee was considering S. 2560, the Intentional Inducement of Copyright Infringements Act (the "Induce Act"). At that time, online piracy seemed unstoppable, and copyright owners were clamoring for some clear boundaries for peer-to-peer technology to be established. I testified in support of the proposed legislation and, at the request of the bill's sponsors, my Office played a leading role in efforts to craft an approach that met the needs and interests of copyright owners, the technology sector, and consumers. I was disappointed that those discussions reached no resolution as the 108th Congress came to a close. However, I think the Supreme Court's ruling this year may well have resolved the issues that were so extensively debated in deliberations over the Induce Act – at least for the time being. In fact, it probably is not much of an overstatement to say that in effect, the Court enacted its own judicial version of the Induce Act when it clarified that "one who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties."[24] The Court's ruling struck an appropriate balance between the rights of copyright holders and the flexibility necessary to enable and encourage technologists to continue to develop new products. It is perhaps because of this balance that the I have not heard of any parties advocating a resumption of discussions on the proposed Induce Act. The Supreme Court seems to have found within existing law sufficient authority and flexibility to accommodate all parties, thereby obviating the need for new legislation. I use the word "seems" because

[24] Slip op. at 19.

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with only three months having passed since the ruling, it is simply too early to tell whether *Grokster* will provide sufficient guidance for the years and circumstances to come.

It may be that in a few years, either copyright owners or technology providers – or both – will conclude that the *Grokster* decision has not adequately addressed the parameters of secondary liability for inducing infringement or that further clarification of the "*Sony* rule" is necessary. I think we need to give the lower courts some time to digest the *Grokster* ruling and give the affected parties time to see how clearly it offers guidance for both copyright owners and technology providers, and how good that guidance turns out to be. What I think is clear is that it is premature to consider the need for any legislation on secondary liability at this time.

However, we do know already that *Grokster* cannot and will not resolve all of the issues that are facing the music industry. *Grokster* addressed only one facet of the piracy problem, the supply of products that purposefully facilitate infringement. To be able to combat piracy effectively, though, the industry must also be able to satisfy the demand from consumers for legitimate online music services. As I said in my recent testimony before this Committee's Subcommittee on Intellectual Property[25] and before the House Judiciary Committee's Subcommittee on Courts, the Internet and Intellectual Property,[26] one of the most significant hurdles facing the music industry is the inefficient

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[25] *Music Licensing Reform: Hearing Before the Subcomm. on Intellectual Prop. of the Senate Comm. on the Judiciary*, 109th Cong. (2005) (written statement of Marybeth Peters, the Register of Copyrights), *available at* http://www.copyright.gov/docs/regstat071205.html.

[26] *Copyright Office Views on Music Licensing Reform: Hearing Before the Subcomm. on Courts, the Internet and Intellectual Prop. of the House Comm. on the Judiciary*, 109th Cong. (2005) (written statement of Marybeth Peters, the Register of Copyrights), *available at*

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process to license musical works that is engendered by the antiquated provisions of section 115 of the Copyright Act. While the *Grokster* decision affords legitimate music services an opportunity to make great strides in further satisfying the demands of the marketplace, it is an opportunity that will necessarily be squandered if Congress does not modernize the existing statutory licensing regime so that legitimate music services can take advantage of the blow the Court has struck against illegitimate offerings, before other illegal sources arise.

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http://www.copyright.gov/docs/regstat062105.html.

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Section 115 of the Copyright Act governs the compulsory licensing of the reproduction and distribution rights for nondramatic musical works[27] by means of physical phonorecords and digital phonorecord deliveries. However, it has rarely been used as a functioning compulsory licenses, serving rather as a ceiling on the royalty rate in privately negotiated licenses and thereby placing artificial limits on the free marketplace. Moreover, its "one-at-a time" structure for licensing individual musical works is incompatible with online music services' need to acquire the right to make vast numbers of already-recorded phonorecords available to consumers. Moreover, many online activities involve both the public performance right and the rights of reproduction and distribution, rights that usually are controlled by separate sets of middlemen in the case of musical compositions, but not in the case of sound recordings. The existing system is characterized by tremendous impediments to efficient and effective licensing of the rights needed by a contemporary online music service. Reform is needed to make it possible to clear quickly and efficiently the necessary exclusive rights for large numbers of works.

During several hearings on this topic before both Subcommittees, the Copyright Office and industry representatives explored various means by which to reform section 115, including transforming the section 115 compulsory license into a section 114-style

[27] It is important to keep in mind that a "musical work" refers to a musical composition (*i.e.*, a song), while a "sound recording" refers to the fixation of a particular performance of a composition (*e.g.*, on an audio compact disc). However, to reproduce and distribute a pre-recorded song, one needs to obtain licenses both as to the musical work as well as to the sound recording.

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blanket license with royalty payments funneled through a single designated agent, expanding the section 115 license to include certain performances such as those that arguably arise in the context of tethered downloads, abandoning the section 115 compulsory license – at least with respect to digital phonorecord deliveries – and replacing it with a system of collective licensing similar to systems in place in many other countries, and/or simply repealing, but not replacing, the section 115 compulsory license so that reproduction and distribution rights would truly be left to marketplace negotiations.

Regardless of which avenue for reform is selected, it is clear that some kind of reform is needed – urgently, in my view. If the legitimate music industry continues to be saddled with a time-consuming and transactionally-expensive licensing process, then it can never compete effectively with the "pirates" who can offer a wider variety of music faster and cheaper. Thus far, the representatives of various copyright owners and music services have been unable to make substantial progress in settling their differences over the shape a new licensing regime should take and the royalties that should be paid to copyright owners. I believe that if there is to be any hope of a resolution, Congress must either send a clear message to the parties or take action on its own to reform the system.

Conclusion

Thank you, Mr. Chairman and all the distinguished Senators of this Committee, for providing me with the opportunity to update you on this landmark decision. I am hopeful that *Grokster* represents a turning point for legitimate online music delivery

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services to secure market dominance. I look forward to working with this Committee and representatives of the music industry on whatever actions are warranted, such as reforming section 115 of the Copyright Act to provide an efficient licensing mechanism for musical works.

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STATEMENT OF MARTY ROE
OF THE BAND DIAMOND RIO
BEFORE THE
SENATE COMMITTEE ON THE JUDICIARY
ON
PROTECTING COPYRIGHT AND INNOVATION
IN A POST-*GROKSTER* WORLD

SEPTEMBER 28, 2005

Mr. Chairman, Senator Leahy, and Members of the Committee, Good morning. I am Marty Roe with the country group Diamond Rio. I'd like to introduce my bandmates Gene Johnson, Dan Truman and Dana Williams that are here with me today. We appreciate the opportunity to speak today to give you an artists' perspective on the Supreme Court's recent *Grokster* decision. We've been signed to Arista Records since 1991 and are blessed to have a career that has spanned well over a decade. I am proud to say that we made history this year with our 15th consecutive Country Music Association Vocal Group of the Year nomination. I am proud to be here this morning representing the music community.

Imagine going to your job 18 hours a day, 7 days a week, 52 weeks a year, working hard to produce a product that you're proud of, that adds value to society. Now imagine that at the end of that year, you receive no paycheck, and no compensation from the millions of people who use every day that product you worked so hard to create. You would have walked off that job long ago. Unfortunately, that's exactly what has happened in the music industry. Not because of any lack of love for music, but for the simple truth that artists and songwriters, like everyone, need to make ends meet.

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Many P2P businesses, like Grokster, have been the main culprit in preventing those artists from making a living. By operating file-sharing networks, encouraging and facilitating the free exchange of millions of copyrighted works, these businesses have devalued our music and created an entire generation of listeners who believe that we don't deserve to be paid for our hard work. The result can be seen from Music Row to Hollywood as artists, musicians, and songwriters have closed up shop. Some have estimated that the Nashville community has lost nearly half of its songwriters, a huge number of whom have been forced to go into other professions in this terrain.

The Supreme Court's decision in *Grokster* offered a unique high note in this otherwise downbeat time. The highest court in the land, in a unanimous decision, saw what we saw—what nearly everyone who seriously considered this issue saw: this was outright theft. And Grokster, and other services like it, were making it happen. The decision gives new hope to a suffering industry by making those services responsible for promoting the theft of our work. It shines a spotlight on shady businesses that have perfected the art of operating in the shadows and blaming others for the resulting illegal activity.

Certainly, some bands have used P2P networks to market themselves and reach a wider audience. If this has worked for them, that's great. But this promotional device should be a choice for each and every artist. No one should decide for me or any other band that a song should be offered for free.

Of course Diamond Rio and I are excited to be a part of the digital revolution. For instance, our music is offered on the current Napster. But these services present a major distinction from Grokster and its siblings: they value our music and encourage

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others to value it as well. For a reasonable fee, the public can get quality downloads without the threat of viruses and spyware. Appropriate payment goes to us and the many people who help us bring our music to you. The *Grokster* decision is important in helping to continue to usher in legitimate online music businesses and a viable—and vibrant—legitimate marketplace.

We're part of a large family—an interconnected network of artists, songwriters, musicians, recording engineers, and others who bring music to life. We have been proud to work in Nashville, the heart of music-making in the country and, indeed, the world. We want to see this family survive and grow, and *Grokster* has played a major part in that.

The *Grokster* decision was helpful because the unanimous Supreme Court set the tone of intolerance for using piracy as a business tool to make profits at the expense of artists. Regardless of the medium, whether it be P2P, radio, downloads, satellite, internet, or any other platform, we hope that Congress will work vigilantly to maintain and assure this tone of intolerance against businesses facilitating theft.

Because by doing so, you will be helping those of us who devote our lives to making the music.

Thank you.

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Senate Judiciary Committee Hearing – Protecting Copyright and Innovation in a Post-Grokster World
Testimony of Scooter Scudieri
Member, DCIA

September 28, 2005

Dear Chairman Specter and Ranking Member Leahy:

I am sorry that I cannot personally participate in the hearing on Protecting Copyright and Innovation in a Post-Grokster World today, but thank you for this opportunity to share my views with you in writing. My name is Scooter Scudieri and I am an artist. I am an independent musician who operates without an agent, manager, or record company and lives in Shepherdstown, WV. I am known in many circles as the Internet's First Rock Star. I speak about the future of music across the country in prestigious colleges and universities and my lecture series "Capture Your Spirit, Keep Your Soul" is endorsed by MEIEA (Music Entertainment Industry Educators Association). I am also a member of the DCIA (Distributed Computing Industry Association), the NAPM (National Academy of Popular Music) and a 2003 Songwriters Hall of Fame Award winning writer. I have toured with famous inter-national musicians in theaters throughout the country and most recently was a speaker at the Digital Media Conference in McLean, VA on June 17, 2005.

I was the only artist present.

As a proud soldier on the front lines of a music revolution I can tell you - it is a great day for independents! We now have our very own distribution system: licensed P2P. As elected officials who serve in part to foster the development of commerce in America, I urge you to allow deployment of new business models for content distribution that are non-infringing and expand the marketplace for digital content.

I continually hear the phrase 'copyright owner' when in fact 'copyright creator' is the only reason the industry exists at all. If you take away the songwriter or the musician – there is no music industry. Somehow, somewhere, someone decided that corporate ownership should control the distribution of copyrighted works and the best way to do that was to OWN the copyrighted works. Thus, a subservient artist relationship began the record industry. Those days can now come to an end. Artists at last can empower themselves with technology and embrace the digital age with both arms.

I own the copyrights of the works I create.

The new peer-to-peer (P2P) music business model contains two elements: the musician and the fan. It is that simple. I have a theory based on careful study and analysis of the corrupt corporate music business model. Free downloads did not begin the dismantle of the record industry. Greed did. Free downloads just allow music lovers the ability to preview what the record labels have been forking out for years and make the decision to not purchase the "music" for $20. It is simple economics. There continues to be a shift in the dynamics of the music industry. Corporate ownership of copyrighted works is part of the antiquated music business model and is no longer necessary in the digital world. Certainly there will be artists who wish to compromise their art in the vain hopes of securing a deal with a major record company. So be it. I just do not want to see the day when record companies will not allow musicians to participate in a P2P distribution deal.

It has always seemed short sighted to me that opponents of the new P2P industry with all their resources would resort to lawsuits against individuals and companies, but never implement or seek to develop an alternative solution themselves. P2P is here to stay and ultimately will be embraced by the very same opponents who wish to crush it now. In the meantime, artists like me will continue to blaze a trail into the future and pave the way for the major record companies to follow.

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Licensing the P2P distribution channel has already been proven to be a highly efficient medium for marketing copyrighted works. I work with P2P companies who promote legal and authorized digital rights management (DRM) technologies, micro-payments, and sponsored content that distribute non-infringing media. The availability of licensed copyrighted material is assured by the software, which automatically makes copies of works available to millions of other users, who each in turn are required to acquire a license under rights-holder stipulated terms, including usage and price.

In my opinion, major record companies have blocked licensed P2P because of the realization that they will lose control of their roster of artists once the word gets out that the legal and authorized P2P medium is a viable and lucrative solution. Now is the time to deploy new business models for content distribution that present a win-win situation remedied to reflect the shift in paradigm of this business we call music.

Without an agent, manager, record company, or marketing dollars my video "Mother of God" was downloaded 50,000 times in April on the P2P networks. It broke 100,000 downloads in June and is projected to break 250,000 by the end of July. These numbers are amazing.

The Internet's first rock star? It's an arguable distinction, but one that I do not take lightly. In the next few months I will implement a sweeping campaign designed to prove that technology has inexplicably leveled the playing field. Two short years ago I was one of a handful of trailblazers forging the way for armies to follow. Now, we have become a conscious and collective movement.

I am passionate about life and love and art. I play my music as if my very life depends on it...because it does. My music offers a powerful affirmation of the human spirit. I use my music as a message of peace, and the Internet as a means to connect us all. I don't have a lot of money, but I have something more important. I have a voice and I have my music. I have a clear line of communication that goes out to the world. That clear line is the Internet and more specifically P2P.

Authorized, legal, and protected P2P downloads are helping an independent artist from SHEPHERDSTOWN, WV make a living outside of the corrupt major label system that is closed to most aspiring musicians.

Art changes the world. Digital technology changed the distribution system. No longer are artists indentured servants to a corporate master.

Artists everywhere need to create, control, and ultimately profit from their copyrighted works. The P2P companies that I work with allow me to do just that...what a wonderful time to be alive.

Please join us and help in this process of creation.

Peace, Scooter Scudieri

HOME: 304-876-0546
CELL: 304-268-4014

VISIT MY WEBSITE: http://www.firstrockstar.com

Summary, Testimony of Gary J. Shapiro on behalf of
The Consumer Electronics Association and the Home Recording Rights Coalition
"Protecting Copyright and Innovation in a Post-Grokster World"
Senate Judiciary Committee
September 28, 2005

The balance may have shifted from a pro-consumer revolution to maximum protection for proprietors. We have long referred to the 1984 *Betamax* decision as the *Magna Carta* for our industry. The principle that copyright proprietors should not be able to impede the design, development, and sale of staple articles of commerce capable of significant non-infringing uses gave technology companies the incentive and the confidence to invest in research and new technology.

In *Grokster* the Court recognized a parallel "inducement" principle, based on subjective intent. Technically the only issue before the Court was the right of two "peer to peer" services to continue to distribute their technologies, despite findings that their prior marketing practices encouraged infringement. Remedies for these prior practices were still subject to lower court consideration. The Court emphasized that its inducement doctrine "premises liability on purposeful, culpable expression and conduct, and thus does nothing to compromise legitimate commerce or discourage innovation having a lawful purpose." Yet examples given by the Court in its opinion could subject creators of new technologies to ruinous litigation. Thus the Court looked back to the *Betamax* case itself and observed that Sony, despite its urging of customers to make and keep home recordings, would not have been guilty of inducement, because neither "home recording" nor "building a library" was "necessarily infringing."

So *Grokster* appears to threaten only inducement of *clearly* unlawful conduct. But, for example, if a single court were now to label as "infringement" consumers' home recording of content they have paid to view or hear, what will be the status of all the product design, research, development, production, marketing, and distribution activity that went into serving these consumers? Scores of products and services are being created and introduced that change how people buy a house, book travel, do research, complete their education, and even run for office. The technologies have improved access to information, education and entertainment and enhanced peoples' lives. All digital technologies involve copying to some degree. The law should not impede or restrict these new and beneficial consumer activities or the digital technology products that make them possible. Yet, all of these commonplace activities implicate conduct – reproduction, distribution, derivative works – that an overbroad interpretation of the *Grokster* case could prohibit. We are at a crossroads in technology. With new technologies allowing every citizen to be a creator, we must accept that our national creativity can no longer be measured by CD sales.

We understand that the ***recording industry*** is approaching another committee of the Senate with a proposal to give the FCC *carte blanche* to impose copy protection technology and requirements on digital audio broadcasts. This proposal is *not* aimed, like the controversial video "broadcast flag," at mass, indiscriminate, anonymous distribution of content over the Internet. It is aimed at private, noncommercial home recording entirely within homes and automobiles. It would change copyright law, yet this proposal has never been examined by your Committee.

Last week the motion picture industry announced that is forming a central laboratory, reporting directly to the CEOs of the major motion picture companies: ***"MovieLabs."*** We fear that its purpose is to control technology via licensing, so only "approved" approaches can be tried. Gathering decision-making and licensing in industry consortia owned and controlled only by content proprietors can be, and perhaps is meant to be, a powerful weapon in the wake of *Grokster*.

Proprietors do not need additional weapons at this time. At a minimum, Congress should do no harm. In the other body, HRRC and CEA continue to support H.R. 1201, a bill that would codify the *Betamax* doctrine, which the *Grokster* court left undisturbed.

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Before the United States Senate
Committee on the Judiciary
Testimony of Gary J. Shapiro
On behalf of the
Consumer Electronics Association
and the
Home Recording Rights Coalition

"Protecting Copyright and Innovation in a Post-*Grokster* World"
September 28, 2005

As the Chief Executive Officer of the principal trade association of the consumer electronics industry, the Consumer Electronics Association,[1] I appreciate the opportunity to discuss the state of my industry in the wake of the Supreme Court's *Grokster* opinion.[2] I am also here today as the Chairman of the Home Recording Rights Coalition.[3] The HRRC was formed in October, 1981, the day after the Ninth Circuit Court of Appeals ruled that motion picture companies had the right to keep consumer video cassette recorders off the market. The reversal of this judgment by the Supreme Court in 1984, in the *Betamax* case,[4] was, if not the vanguard, then the safeguard for a technological revolution that has empowered consumers and created new markets for content providers in ways that previous generations could only dream about.

The *Betamax* decision gave technology companies the confidence to imagine, design and create today's digital revolution in audio, video, text, hypertext and interactive media. In a Post-*Grokster* World, the balance may have shifted from a pro-consumer revolution to maximum protection for proprietors. I think we have every right to be concerned that the creativity and

[1] CEA is the principal trade association of the consumer electronics and information technology industries and the sponsor of the International Consumer Electronics Show. CEA represents more than 2,000 corporate members involved in the design, development, manufacturing, distribution and integration of audio, video, mobile electronics, wireless and landline communications, information technology, home networking, multimedia and accessory products, as well as related services that are sold through consumer channels. Combined, CEA's members account for more than $121 billion in annual sales. CEA's resources are available online at www.CE.org,
[2] *MGM Studios Inc. v. Grokster, Ltd.*, 125 S. Ct. 2764 (2005).
[3] www.HRRC.org.
[4] *Sony Corp. v. Universal City Studios*, 464 U.S. 417 (1984).

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innovation the public expects and deserves from American industry may be subject to very serious, and unwarranted, constraints.

We have long referred to the 1984 *Betamax* holding as the *Magna Carta* for our industry. The firm principle that the Court established – that copyright proprietors should not be able to impede the design, development, and sale of staple articles of commerce capable of significant non-infringing uses – gave technology companies the incentive and the confidence to invest in research and new technology. The *Betamax* Court said that any other result would "block the wheels of commerce," and history has affirmed this judgment.

In *Grokster*, the Court did not overturn or even disturb its *Betamax* holding. For this, my colleagues and I in the technology industries are both grateful and relieved. The Court did, however, recognize a parallel "inducement" doctrine, based on subjective intent. The Court said that even though the technologies and the products themselves remain protected by the *Betamax* doctrine, a company may still be held liable based on conduct aimed at encouraging and facilitating "copyright infringement." I am concerned about the future interpretation of this doctrine in the lower courts, in an environment in which content providers and distributors *already* have been given and continue to seek an even broader array of tools to constrain the lawful activities of consumers and independent manufacturers and retailers.

Pros and Cons of *Grokster*

The old adage is that hard cases make bad law, and *Grokster* was a hard case. Technically, the only issue before the Court was the right of two "peer to peer" services to continue to distribute their technologies, despite findings that their *prior marketing practices* encouraged infringement. These prior practices were not before the Court, and remedies for them were still subject to lower court consideration. The Circuit Court opinion from which the

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plaintiffs appealed was willing to assume, in finding for the defendants, that the conduct encouraged by their previous practices was clear copyright infringement. Under this circumstance, the Supreme Court refused to shelter the defendants' software technology, under the *Betamax* doctrine, without considering these prior marketing practices.

In its unanimous decision, the Court emphasized that its parallel "inducement" doctrine was meant to apply only to bad actors. The Court, during oral arguments and in its decision, expressed concern that, consistent with the *Betamax* decision, the law should ensure that the technology community will not be subject to suit simply because new technologies could also be used for infringement.[5] Therefore, the Court emphasized that this inducement doctrine "premises liability on purposeful, culpable expression and conduct, and thus does nothing to compromise legitimate commerce or discourage innovation having a lawful purpose." This doctrine, correctly understood, and particularly in light of facts that the Court found to be egregious and willful, should only reach those who knowingly and unambiguously intend that their conduct will promote copyright infringement. It should not penalize companies from developing and marketing products that are intended to promote commercially significant lawful

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[5] For example, Justice Breyer asked counsel for the petitioner:

[A]re we sure, if you were the counsel to Mr. Carlson, that you recommend going ahead with the Xerox machine? Are you sure, if you were the counsel to the creator of the VCR, that you could recommend, given the use, copying movies, that we should ever have a VCR? Are you sure that you could recommend to the iPod inventor that he could go ahead and have an iPod, or, for that matter, Gutenberg, the press?

Transcript at 10.

Similarly, Justice Souter asked:

The question is, How do we know in advance ... anything that would give the inventor, or, more exactly, the developer, the confidence to go ahead?

Transcript at 14.

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conduct, as well as to promote conduct that these companies could *reasonably have believed* to be non-infringing.

The examples given by the Court, however, if interpreted too broadly, could subject new technologies, and their creators, to abusive litigation. Our copyright laws, and their potential penalties, make the prospect of this sort of litigation extremely risky and potentially fatal for startups, and even for strongly capitalized, established companies. Therefore, even though the Court had bad actors in mind, a broad interpretation of its holding would raise a clear and present danger to American competitiveness.

The Court, by way of example, cited three inter-related ways in which the *Grokster* defendants stepped outside of the shelter of the *Betamax* defense:

- Each of the defendants "aimed to satisfy a known source of demand for copyright infringement…."[6]
- Each of the defendants failed to attempt to develop a filtering tool to diminish infringing activity. Though not independently actionable, this could be a consideration in the presence of other evidence of intent.
- Each defendant's profitability "relied on" the infringing conduct of the users of the technology. (This, like the second factor, contributed to a finding of malign intent, but was not enough to support such a finding on its own.)

Although the Supreme Court's target was narrow, the subsequent interpretation of these factors, and others perceived by lower courts, could be uncomfortably broad. Perhaps for this reason, the Court felt constrained to look back to the *Betamax* case itself, and to see whether its new doctrine might have applied there. After all, as the Court noted, it was undisputed in that case that Sony encouraged VCR buyers to "build a library," *as well as* to "time shift" movies,

[6] The reference was to the Napster service, as previously configured, which had been ruled infringing and shut down by the same Court of Appeals that had refused to issue an injunction against the present technologies used by the *Grokster* defendants.

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and the Court had specifically identified only "time shifting" as a fair use.[7] Fortunately, the Court in its unanimous opinion said that Sony, despite this knowledge, and its own urging of customers to make and keep home recordings, would *not* have been guilty of inducement, because neither conduct induced by ads telling consumers to "record favorite shows" nor by ads inviting them to "build a library" was ***"necessarily infringing."***[8] Therefore, Sony had not been shown to have a malign intent in designing, building, and selling this product.

Our Concerns For The Future

In a digital universe, where virtually every device works by first making or storing a digital copy of material that potentially is protected by copyright, fair use is simply essential to American law. Without fair use, even emails and browsing might have to be explicitly authorized and licensed by several content proprietors every time, or the copyright laws would have to become a code of approved practices. After *Grokster*, we know that on the one hand, conduct might be considered to be "inducing infringement" *unless* the copying in question has been licensed or is found to be a fair use. On the other hand, we have the Supreme Court's assurance that the practices seen as reasonable by most Americans are not "*necessarily infringing*." Can the developer of the next VCR go to the bank on "not necessarily?"

For now, we think we can view the *Grokster* case as a threat only if the copying that is induced is *clearly* unlawful. But we can also observe that virtually every technologist is now open to suit, and that the minute any court declares some user activity *not* to be a fair use, a vast

[7] The *Betamax* court never said whether "building a library" – making a home copy and keeping it – was or was not a fair use, and the question remains controversial to this day. HRRC and CEA believe that home "librarying" for private, noncommercial purposes *is* a fair use, but leaders of the Motion Picture Association of America and the Recording Industry Association of America have said on many occasions that they believe it is *not* a fair use.
[8] 125 S. Ct. 2764 , 2777 (2005, emphasis added)

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range of heretofore legal design, manufacturing, marketing, and sales practices is placed into legal and business jeopardy.

Concerns For Consumers And Consumer Electronics

For example, what if some particular activity of consumers – even one recognized by some Members of Congress as reasonable and customary, such as sending a copy of a local radio broadcast to your brother living across the country; or recording *The Sopranos* from a cable channel – is now held by a single court to be an "infringement?" I doubt that even the most scrupulous consumer would think this type of conduct might somehow impinge anyone's copyright. Think of all the commercial interests, including program distributors, that have supplied hardware, software, and program guides that advertise, encourage, and aid in this behavior, have made it more seamless and interoperable for consumers, and have not "filtered" it out. Are they all suddenly guilty of "inducement?"[9]

The *Grokster* case itself was about defendants that the Court viewed as bad actors engaging in egregious conduct, on a massive scale, sending content among millions of people who had no relationship with either the sender or the proprietor of the content. But will the courts now apply the same doctrine to technologies and companies that serve consumers who

[9] Just a few years ago, Replay, a company marketing personal video recorders, was driven into bankruptcy defending copyright litigation brought by MPAA members. An entire chapter of the complaint brought by MGM, Orion Pictures, Fox Film Corporation, Universal City Studios Productions, and Fox Broadcasting specifically attacks standard features, found on any PVR product, as "inducements" to copyright violation: "Defendants cause, accomplish, facilitate and ***induce*** the unauthorized reproduction of Plaintiffs' copyrighted works in violation of law. *** The ReplayTV 4000 device provides expanded storage, up to (currently) a massive *320 hour* hard drive, which allows the unlawful copying and storage of a vast library of material. *** ReplayTV 4000's expanded storage and sorting features organize disparate recordings into coherent collections, and ***cause, facilitate, induce and encourage*** the storage or "librarying" of digital copies of the copyrighted material, which harms the sale of DVDs, videocassettes and other copies, usurps Plaintiffs' right to determine the degree of 'air time' a particular program receives in various cycles of the program's distribution ...." *Metro-Goldwyn-Mayer Studios, Inc. et al v. ReplayTV, Inc.*, U.S. District Court, Central District of California, Case No. 01-09801, Complaint of MGM, Orion Pictures, Twentieth Century Fox, Universal City Studios, and Fox Broadcasting, ¶¶ 24-25, November 14, 2001 (some emphasis supplied). Pleadings in this case can be found at http://www.eff.org/IP/Video/Paramount_v_ReplayTV/.

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pay for their content in their cable bills or satellite bills, buy it on a CD or DVD, and listen to advertising on the radio? If a single court were now to declare one of their recordings to be an "infringement," what is the status of all the product design, research, development, production, marketing, and distribution activity that went into serving these consumers? They may all be targets for potential plaintiffs, and their contingent fee lawyers.[10]

Concerns For American Competitiveness

My concerns go beyond the immediate worries of the hardware and software developers in my own industry – important as they are to me. The potential chilling effect of a broad reading of *Grokster* goes to any number of similar circumstances and "gray" areas into which developers of digital products, software, and media *must* venture in a digital age.

The moment a technology developer is sued under the copyright law – whether it is a startup or a giant company – its future its placed in jeopardy because of the copyright law's "statutory damages" provisions.[11] This could be particularly ruinous for the very cutting edge technologies on which American competitiveness depends.

Scores of products and services are being created and introduced that change how people buy a house, book travel, do research, complete their education, and even run for office. The technologies and products made and sold by the 2000 corporate members of CEA have changed existing business models. In most cases they have improved access to information, education and entertainment and enhanced peoples' lives.

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[10] In the patent law, from which the inducement doctrine is derived, there is generally only one potential plaintiff, the patentee. In the copyright world, anyone who can write, sing, dance, act, take a picture, or publish is a potential plaintiff.

[11] 17 U.S.C. § 504(c) allows "the copyright owner [to] elect … to recover, instead of actual damages and profits, an award of statutory damages for all infringements involved in the action, with respect to any one work … in a sum of not less than $750 or more than $30,000 as the court considers just." For instances found to be committed "willfully," the award for each infringement may be as high as $150,000. These amounts were *increased* by the Congress in 1999.

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On any typical day, the wired American family sends news articles to friends and colleagues over the Internet; rips songs from Compact Discs to home computers and portable players; downloads pictures and audio or video clips, or finds quotations and snippets of information from all across the Web, to be used in school and business reports; and copies information from home repair, cooking or shopping websites. Today's teenagers, whose schoolwork relies on access to computers and multimedia, take these images and sounds and text and experiment by mashing them together in endlessly creative and intuitive ways. Digital technology has made us a nation of samplers. The law should not impede or restrict these new and beneficial consumer activities or the digital technology products that make them possible. Yet, all of these commonplace activities implicate conduct – reproduction, distribution, potentially derivative works – that an overbroad interpretation of the *Grokster* case could prohibit.

We are at a crossroads in technology. With broadband considered a national priority, with intense competition coming among alternative media providers, and with the Internet and new technologies allowing every citizen to be a creator, we must accept that our national creativity can no longer be measured by CD sales. With photo and video editing and audio studios shifting to American homes, with the Internet, both wired and wirelessly, providing an array of outlets for distribution, with new technologies bursting forward, now is *not* the time to chill the initiative of American hardware, software, and service developers.

Yet the reaction to *Grokster,* in many places has already been to feel a chill. We've seen headlines, nationally and internationally, such as –

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"Ten Years of Chilled Innovation"[12]

"Technology Feels the Chill"[13]

Some might say that these respected business publications are engaging in hyperbole or "fearmongering." But based on the uncertain implications for my own industry, I can't. I'd have to say that a broad lower court interpretation of *Grokster* would be part of a disturbing trend.

A Disturbing Trend

Over the last decade, copyright law has repeatedly been amended to enhance the rights of copyright owners toward increased protections for the content community against the potential "threat" of digital technology. This has at times come at the expense of the rights of consumers or technology innovators to engage in lawful, non-infringing conduct. Consider that in 1998 Congress added some 20 years to the already lengthy statutory copyright term, thus taking from the public domain, and from the ability of new creators to make new versions and adaptations, billions of dollars worth of content. Every one of these works, which otherwise would have been in the public domain, now can be the subject of an "inducement" charge aimed at some technologist.

Copyright has been the basis for a number of dominos to fall. Individually, they may have been justifiable. Cumulatively, the effect may be stifling, and may be tilting the balance, between copyright proprietors and users, on which new technology depends. Congress restricted the right to rent music CDs in 1984; it made it illegal to create or, arguably, even to discuss, technologies which somehow get around a copyright protection scheme in 1998; it *increased* statutory copyright damages in 1999; it created separate positions in the Executive branch to

[12] http://www.businessweek.com/technology/content/jun2005/tc20050629_2928_tc057.htm
[13] http://technology.guardian.co.uk/online/story/0,3605,1555375,00.html

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pursue IP violations; it implicitly said that having a large number of songs, plus certain technology, on your computer can be a violation of copyright law. To date the RIAA has sued some 10,000 Americans, mostly teenagers, their parents and grandparents, and ruined some families financially.[14] After my friend Jack Valenti retired, the MPAA began suing consumers as well.

And now, even as we speak, we understand that the recording industry is approaching another committee of the Senate with a proposal to give a regulatory agency, the Federal Communications Commission, *carte blanche* to impose copy protection technology and requirements on the digital audio broadcasts that local radio stations are just beginning to offer. The RIAA proposal is *not* aimed, like the controversial video "broadcast flag," at mass, indiscriminate, anonymous distribution of content over the Internet. The video broadcast flag would not prohibit the making of timeshift copies from television broadcasts. But the audio "flag" goes much further. In fact, it specifically is aimed at private, noncommercial home recording entirely within homes and automobiles, essentially by prohibiting consumer electronics companies from incorporating otherwise legitimate features into products that record off the air. It would work an enormous substantive change to copyright law, yet this proposal has never been examined by your Committee.

A Licensed Universe

There has been an equally disturbing trend, which I fear that the *Grokster* decision may accelerate and aggravate: ***Content owners and service providers controlling and channeling hardware and software development only along approved lines.***

[14] With an average settlement of $3000 per lawsuit, the RIAA has made some $30 million on this venture.

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Already, content providers and distributors have been moving to announce *in advance* that they will "license" only technologies and techniques that are satisfactory to them, and will not license, or will challenge, others. Already, the ability of competitive manufacturers to implement a law passed by the Congress in ***1996*** to assure that competitive products can work directly on digital cable and satellite systems has been slowed by the exertion of centralized control over product licensing, ***in response to movie industry contracts***, by a technology consortium owned by the cable industry, "CableLabs."

Last week, the motion picture industry announced that is forming a similar central laboratory, reporting directly to the CEOs of the major motion picture companies: ***"MovieLabs."*** The purpose of MovieLabs, according to statements attributed to a senior studio executive, is to fill "gaps in research on content protection left by consumer electronics companies and Silicon Valley."[15] In reality, though, the market for such new "DRM" technologies has been highly competitive and more than robust. Something more seems to be going on, and it seems to me to be tied to *Grokster*.

At present, DRM technologies are licensed by the technology companies that developed them. Often, these companies are *also* developers of consumer products, and are reluctant to impose, by license, limitations on the usefulness of the these products in the hands of consumers. This has led to negotiation about the nature and level of "protections" to be applied, with at least some of the parties sticking up for product innovation and consumers' expectations.

Gathering decision-making and licensing in industry consortia owned and controlled ***only*** by content proprietors can be a powerful weapon in the wake of *Grokster*. If, for example, common and accepted consumer practices with respect to home video and audio recording are

[15] *See*, http://www.nytimes.com/2005/09/19/business/19film.html?ex=1127793600&en=fb357f94a7634723&ei=5070&emc=eta1

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further refined into "acceptable" and "not acceptable" elements according to the content industry owners of MovieLabs, they can exert formidable ***licensing power*** in order to get their way.[16] They might use *Grokster* to insist on the use of "filtering" technologies and thereby to label undesired outcomes as "infringement." They can threaten, in the wake of *Grokster*, to file suit, and go back through an entrepreneur's research, design, and marketing history seeking evidence that such "infringement" has been actively "encouraged" or "induced" by the hardware or software developer. With "enhanced" statutory damages available under U.S. copyright law, only the bravest or wealthiest manufacturer or software developer could stand up to such pressure.

Each week since the *Grokster* decision, one reads of technology companies "signing on" to proprietary schemes, and relinquishing independent design of their own new products. The Congress and the courts need to be alert to the prospect that copyright interests may combine their licensing leverage and their new legal tools to chill *any* U.S. technological innovation that is not in a direction of which they approve. Such a development would go directly in the *opposite* direction set by the Supreme Court in *Betamax* and left undisturbed in *Grokster*. In *Betamax,* the Court repeated its observation, in cases ranging back almost a century, that such prior control of technology by other proprietors "would block the wheels of commerce."[17] Unfortunately, today, with changes in the law shifting the balance away from technology to copyright owner rights, some companies are engaging in "self-censorship" of innovative new and lawful products solely in hopes of avoiding the expense and risk of copyright litigation.

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[16] The sheer market power gained by melding *all six* Hollywood studios into a single licensing consortium may be an object of interest to this Committee.

[17] 464 U.S. at 441-42, citing *Henry* v. *A. B. Dick Co.*, 224 U.S. 1, 48 (1912), overruled on other grounds, *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U.S. 502, 517 (1917).

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New Legislation

As I indicated above, in the wake of *Grokster* this is *not* time to be handing even more potential weapons to copyright proprietors to use against technologists – at least, unless the Congress were *also* to enact firm, meaningful, and reliable safeguards for the consumers who would use these products, and (in the era of "inducement") for the technologists who develop them.

At a minimum, Congress should do no harm. In the other body, HRRC and CEA continue to support H.R. 1201, a bill that would codify the *Betamax* doctrine, which the *Grokster* court left undisturbed. We are not asking for a reversal or revision of the *Grokster* decision, but if the content community insists that they need further protections under the law, then we ask at a minimum that clear protection for manufacturer and consumer rights and expectations be part of the equation.

Thank you again for the opportunity to have come here today to discuss this extraordinarily important subject.

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STATEMENT OF CARY SHERMAN
PRESIDENT
RECORDING INDUSTRY ASSOCIATION OF AMERICA
BEFORE THE
SENATE COMMITTEE ON THE JUDICIARY
ON
PROTECTING COPYRIGHT AND INNOVATION
IN A POST-*GROKSTER* WORLD

SEPTEMBER 28, 2005

Mr. Chairman, Senator Leahy, and Members of the Committee, I appreciate the opportunity to testify today on the Supreme Court's *Grokster* decision and its implications for copyright and innovation in the coming years.

Clearly, the decision in *Grokster* was a defining moment for distribution of music and other creative content in the digital age. The Court, in a rare unanimous decision, recognized that those who actively induce or encourage others to steal copyrighted works may be held liable themselves for the resulting infringement. The language of the opinion may be legalese to many, but the message was simple: theft, in any medium, is unacceptable, and those who facilitate it may be held responsible.

The music industry has been hit particularly hard by the massive theft occurring on illicit peer-to-peer ("P2P") file-sharing networks like Grokster. These networks have allowed computer users to illegally copy and distribute millions of songs, movies, software, and other creative works for free. As former Solicitor General Theodore B. Olson said, this is "the greatest ongoing theft of intellectual property that the world has ever seen." And the negative impact of this theft on legitimate sales has been substantial. In 1999, the value of unit shipments reached nearly 15 billion dollars. By 2004, that figure had plummeted to around 12 billion dollars. SoundScan has reported that, through

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the week of September 4th of this year, album sales are down 8.5% versus the same period for 2004.

Record companies are essentially venture capitalists, investing in human beings who create music, in the hope that they will create music that people will want to hear, and buy. The revenue we earn from the sale of recorded music is ploughed back into new music and new artists. It's a risky business, with only about a 10% success rate. Yet, releases from the most popular artists (which make up most of that successful 10%) are often the ones most heavily pirated on illegal file-sharing networks. According to Soundscan, the top 10 albums sold 54.7 million units in 1999, compared to 37.4 million units in 2004, a drop of 32%. The top 100 albums sold 194.9 million units in 1999, compared to 153.3 million units in 2004, a decline of 21%. The result is less money to invest in new artists and new music.

Numerous studies by academics have confirmed that illegal file-sharing has had a direct negative effect on music industry sales. And we're not the only ones. Motion pictures, software, video games – all are impacted. The U.S. economy and the industries that employ over five million Americans and account for over 6% of the nation's GDP have all been hit by illegal file-sharing.

Of course, these numbers don't fully capture the personal toll exacted by this illegal activity. Composers, artists, musicians, technicians, and a multitude of others engaged in the music, film, and other entertainment industries have seen their jobs disappear. Thousands of music stores across the country have had to close their doors. Left unchecked, the networks that promoted this illicit activity threatened to instill in an

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entire generation a culture of lawlessness and a complete lack of respect for copyright and the valuable works it protects.

The decision in *Grokster* helps to change all that. The Court overturned two lower court rulings to recognize that companies, like Grokster, that provide the tools and promote online infringement must be held accountable. It clarified that inducing and encouraging infringement are just as much a part of copyright law as the doctrines of contributory infringement and vicarious liability. This result is completely consistent with the landmark *Sony Betamax* case which, the Court noted, "was never meant to foreclose rules of fault-based liability derived from the common law."

In fact, the *Grokster* decision does nothing to change the holding in *Sony Betamax*. Rather, it shows that the Ninth Circuit's interpretation of the case—which, among other things, required knowledge of each and every infringement at the time of the violation as well as the ability to prevent the infringement at that time—was wrong. Simply, courts are not required to "ignore evidence of intent if there is such evidence...." And there was plenty of evidence of what Grokster intended. As the Court noted, "the unlawful objective is unmistakable." Without giving away our property and the property of thousands of others for free, and thereby earning revenue from spyware and advertising aimed at those looking to steal, services like Grokster would go broke. A business model predicated on theft is unacceptable. The Supreme Court injected into copyright law some common sense, based on centuries of common law.

The Court was also careful to balance the interests of content innovators and technology innovators, noting that their ruling in *Grokster* "does nothing to compromise legitimate commerce or discourage innovation having a lawful purpose." By focusing on

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the *behavior* of Grokster and similar companies, and not the technology they used, the Court separated the good actors from the bad actors, and left intact the *Sony Betamax* standard that has served creators, technology developers, and consumers so well.

It is not surprising, therefore, that the Court's decision in *Grokster* has generated such widespread praise, from companies and opinion leaders across the business and ideological spectrum. Editorials in the New York Times and the Wall Street Journal, the Washington Times and the Washington Post, the LA Times and the San Jose Mercury News, have uniformly congratulated the Court on its carefully balanced, unanimous decision.

Grokster has sent a clear message to those businesses that continue to actively facilitate infringement: It's time to go legit. The clarity provided by the Court, rather than stifle innovation, will increase it. Venture capital will flow to technology companies that respect property and reward the future of music. Companies like iMesh, Snocap, Mashboxx, Passalong, and Wurld Media, as well as new technologies that operate within the law, will have a chance to gain traction, attract investors, and appeal to fans. Within days of the decision, venture capital firms were calling legitimate companies offering licensed P2P services, looking for opportunities to invest. And as the clear message of the Supreme Court's ruling has sunk in, more and more of the illicit P2P companies have looked for ways to go legit, to pay creators, to offer consumers an even better musical experience.

The *Grokster* decision ensures the healthy growth of a legitimate market eagerly seeking support. Apple's iTunes, Real Networks' Rhapsody, Napster, Ruckus, Cdigix, Walmart, Yahoo, and many others have worked hard to build successful destinations for

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legitimate online music. In March 2005, 26 million songs were purchased from digital music stores in the United States.[1] Forty-three percent of music downloaders in 2005 have tried legitimate online music services[2] and 34% of current music downloaders say they now use paid services.[3] For 2005 (through week of September 4th), 217.4 million digital tracks have been sold, versus only 78.6 million sold for the same period in 2004. The growing interest in these services can be clearly seen on the campuses of colleges and universities across the country. Nearly 70 schools now have deals with a legitimate service, a more than threefold increase from just last year. The decision in *Grokster* has played a major role in this growing trend, focusing attention on the issue of illegal file-sharing and providing school administrators with undeniable moral and legal clarity.

In fact, it has provided *everyone* with clarity. Those who make the music, movies, software, and other creative content we love now know that their hard work will be protected. Consumers can now look forward to more of these great works and know that they can get them in a safe, secure, respectful, and legal way. Those who seek to bring us content in fresh and innovative ways on new and old distribution platforms now know that they don't have to compete with illicit free-riders offering the same content for free. Those who seek to support these exciting new legitimate products and services can now have renewed faith in their investment. And those who choose to continue their businesses with a model based on theft now know that there is no excuse. The time to go legit is now.

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[1] NPD MusicWatch Digital Service.
[2] Pew Internet and American Life study, March 2005.
[3] Pew, March 2005.

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We know that a judicial decision, even a decision of the U.S. Supreme Court, is not a magic bullet. It won't automatically eliminate piracy or improve sales. But the Court has laid down a legal and cultural marker. Those who don't play by the rules now know that it is not acceptable to reap ill-gotten gains while burying their head in the sand. And the absurd notion that, somehow, it's okay to take someone else's property just because you can, has been shown to be precisely that – absurd.

The *Grokster* decision gives us the chance to compete in a legitimate marketplace, to earn a return on our investment, to continue offering great music for fans everywhere. We look forward to making our music available in a myriad of new and exciting ways in the years to come.

Thank you.

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Senate Judiciary Committee Hearing – Protecting Copyright and Innovation in a Post-Grokster World
Testimony of Sam Yagan
President, MetaMachine, Inc.

September 28, 2005

Dear Chairman Specter and Ranking Member Leahy:

Thank you for holding this important and timely hearing on protecting copyright and innovation in a "Post-*Grokster*" world. I greatly appreciate your leadership and that of your Judiciary Committee colleagues. We appreciate the opportunity to share eDonkey's perspective on this critical industry and consumer issue.

I. Preface

My name is Sam Yagan. I currently serve as President of MetaMachine, Inc., developer and distributor of the industry-leading peer-to-peer (P2P) file-sharing software application called eDonkey.

Prior to joining MetaMachine, I co-founded and served as CEO of the educational publishing company SparkNotes, which Barnes & Noble, Inc. acquired and now owns. I hold a Bachelors Degree in Applied Mathematics from Harvard University and an MBA from Stanford University. My wife and I live in Cambridge, Massachusetts.

I would like to preface my remarks with a few comments about my presence before this committee: I have no specific agenda to advance. I am not a P2P zealot. I generally turn down speaking engagements other than those directly supporting the development of solutions to the ongoing conflicts between content rights holders and technology developers. I accepted your invitation because I hope that my deep commitment to making peace with the entertainment industry, which I have already communicated to the RIAA, will allow us to engage in a productive, forward-looking dialogue without rehashing our past differences.

I have made public addresses just twice before today: at the Cato Institute conference on "The Law and Economics of File Sharing" in June 2004 and at the U.S. Federal Trade Commission "P2P Workshop" in December 2004. I accepted those speaking invitations, as I accepted yours, because they provided an opportunity to advocate for practical market-based solutions to the problems facing rights holders and technologists. To be clear: I am not testifying for personal publicity or to promote eDonkey; rather I appear before you out of a sense of obligation – a sincere hope that my experiences can help move this discussion forward.

I hold no animosity toward entertainment industry executives or others who have opposed the advancement of P2P technologies over the last few years. Even those of us within the file-sharing industry have struggled to understand these constantly evolving technologies and how they impact other industries. However, given my relatively unique vantage point on the cutting edge of technological development, I have grave concerns about whether the rewards of entrepreneurship in the future will outweigh the substantial risks associated with developing innovative new technologies. Perhaps the most important message I hope to communicate stems from my passion for entrepreneurship – please, try to empathize with a young entrepreneur trying to innovate in a nascent industry. I hope you will do all that you can to nurture and encourage that entrepreneur and provide her an environment in which she can face the myriad challenges that startups do without the additional burden of having to wonder how a judge many years in the future will construe her every thought, email, and business plan.

II. Background on MetaMachine, Inc., eDonkey, and Overnet

The names can get a bit confusing, so let me clarify the various names associated with our business. We conduct business under our corporate name, MetaMachine, Inc. We distribute our file-sharing software under the brand name "eDonkey" (formerly known as "eDonkey2000"). This highly advanced file-sharing application functions as a completely distributed, self-organizing P2P software client and supports redistribution of all file types running on Windows, Mac OS X, and Linux. The name "Overnet" describes the underlying communication protocol that eDonkey clients, or personal computer (PC) software programs, use to search other clients and find files for downloading. Thus "Overnet" functions similarly to "FastTrack" or "Gnutella."

MetaMachine, Inc., a New York corporation founded in 2001 develops and distributes eDonkey, which many research studies cite has having a larger user base than any other P2P application. We incorporated MetaMachine in the United States because we believed at the time, as we continue to believe to this day, that software development was, is, and should be a legal, respected, and encouraged activity in the United States.

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We have succeeded in developing an innovative technology and a global user base. By incorporating in the U.S., we agreed to abide by the laws of this great nation and have generally made ourselves available to government agencies, the press, and most importantly, the entertainment industry. Unlike some of my colleagues, I have reached out to the major labels and studios in hopes of finding partners to collaborate in developing an innovative new channel for licensed distribution of music and video content.

In fact, seven of the top ten major P2P software companies have chosen to locate outside of the U.S. We must all keep this geographical issue in mind when assessing the practical benefits of any proposed legislation. First, we must consider if the legislation will affect entities outside U.S. jurisdiction; second, we must consider the possible costs of pushing technology entrepreneurs offshore.

I hope America can continue to support innovation, both creative and technological, based on the free-market drivers of capitalism rather than attempting to control and guide technological innovation in a centralized manner that may unintentionally drive innovation underground and offshore.

III. Outreach: Our Good Faith Effort

I have spent an immense amount of energy trying to acquire licensed content from the major rights holders. As noted in my preface, I also spoke at the June 2004 Cato Institute conference on file sharing and provided testimony at the December 2004 Federal Trade Commission (FTC) Workshop on P2P in support of licensing content for authorized P2P distribution. In my comments at both of these events I pleaded with content owners to engage with us in productive dialogue.

Our company also participated with nine other companies in the Distributed Computing Industry Association's (DCIA) P2P Revenue Engine (P2PRE) project, which focused on providing a robust solution for major entertainment content rights holders to securely market their copyrighted works via a P2P distribution channel. Although we had no way of knowing whether the P2PRE would work, we embraced the opportunity to experiment with a receptive partner in the entertainment industry.

For that project, we developed technical plans and business models, not only to secure and monetize licensed content entered into P2P distribution by rights holders or their authorized agents, but also to address their greatest concern: the redistribution of unlicensed content that has been entered into the P2P environment from unprotected CDs and DVDs directly by consumers. The P2PRE project held multiple meetings with major music labels and publishers as well as movie studios, and at one point, received verbal commitments from major entertainment firms to proceed with proof-of-concept technical testing and market trials.

The firms later rescinded these approvals, however, with the private explanation that to proceed in collaboration with eDonkey on a business solution, or even to appear to be doing so, could jeopardize the case of the petitioners in the pending *MGM v. Grokster* litigation.

I also reached out to major labels outside of the context of the DCIA's P2PRE. eDonkey sought to enter into constructive negotiations with major labels and studios to license content for distribution by means of innovative P2P business models. I had lengthy conversations with two major music labels and came close to striking a deal with one of them. Our negotiations ended when they required me to do things with the eDonkey application that I simply could not do technologically, ethically, or without taking on even more legal exposure.

I should note that we participated in all of the above talks against the advice of our counsel who urged us not to engage in such dialogue out of fear that comments I would make at these meetings might hurt our case in any future litigation.

In the meantime, however, we began to license audio and video content from small, progressive, independent rights holders directly and through innovative new companies that have begun to emerge, such as INTENT MediaWorks, Shared Media Licensing, and Altnet.

I can point to two successful campaigns that we ran directly with artists. In one case, we worked with Rock and Roll Hall of Famer Steve Winwood to promote the release of his new album *About Time*. We promoted a video of Mr. Winwood performing the song at a live venue as well as a video of him recording the track in his studio. We also worked with a band called Bishop Allen, which we promoted very heavily in the eDonkey

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application, contributing to its sales of tens of thousands of CDs as well as its brief appearance on Amazon's top ten in sales.

As a graduate student at Stanford University, I conducted a study on possible new business models for the music industry given the advent of file sharing and in particular looked at independent bands and their use of P2P as a distribution mechanism. Without exception, every independent band I interviewed begged for increased distribution – gladly willing to distribute promotional music for free in the hopes of gaining fans and widespread popularity. In fact, after file-sharing, the technique most cited by independent bands for acquiring fans was taping signs to lampposts. I find it difficult to refute the fact that many independent bands thrive on the distribution offered by P2P application, even in its current "open" form.

IV. Our Mission

eDonkey's mission has always been to create cutting-edge technology for the distribution and storage of digital content. We foresaw numerous legitimate uses including distribution of content by rights holders and redundant data storage for corporate and individual users. For example, we held extensive conversations with one radio producer who wished to link to archived versions of his radio show. Rather than shoulder the distribution costs himself, we wanted to link directly to a file resident in an eDonkey client.

We faced the common challenge of building a business that required both content and users. Without users we could not get the attention of the content rights holders and without content, we obviously could not market content to users. To remedy the content issue, we not only partnered with existing distributors of independent music and film, but at one point we actually tried to start our own film distribution business called Transmission Films. In this business we acquired the rights to distribution over 100 independent films.

I would like to reiterate this fact: We were rights holders trying to generate revenue from the sale of licensed content on our very own eDonkey application! With our own library of films and partnerships with other distributors, we hoped to prove the efficiency of our application and qualify ourselves as worthy of having serious discussions with the major entertainment rights aggregators.

V. Industry Dynamics

We compete with other P2P distributors primarily on ease-of-use, quality of search results, and speed of downloads. We have succeeded by improving the look-and-feel of our user interface, making it cleaner, simpler, and more easily navigable. We have also improved the functionality of the eDonkey software through a series of new releases that have provided for more comprehensive searches of available content, better displays of search results, faster delivery of selected searches, more features to help organize content, and greater reliability in terms of the integrity of files delivered in response to search queries.

We have received favorable consumer response according to recent studies released by industry data resource BigChampagne and research firm CacheLogic. Our user numbers have steadily increased in absolute terms as well as in terms of market share.

According to BigChampagne, the average number of P2P users online at any given time has grown by more than forty-one percent (41%) during the past year – now nearly ten million (10,000,000) – and according to CacheLogic, eDonkey's global market share has increased to approximately fifty percent (50%).

A recent study conducted by intelligent broadband network equipment maker Sandvine, confirms that eDonkey continues to lead P2P file-sharing software programs in France and Germany, which currently reflect the highest broadband usage of any nations, and are significant to our discussion here because they may represent relevant future trends for the U.S. market. According to Sandvine, in Germany, eDonkey handles about seventy-two percent (72%) of all file-sharing traffic, while BitTorrent consumes about sixteen (16%). eDonkey captures eighty percent (80%) of all French P2P traffic with BitTorrent trailing behind FastTrack and Gnutella.

In Europe, where broadband adoption has steadily outpaced the United States, upstream traffic represents up to eighty-five percent (85%) of all bandwidth consumed on broadband provider networks. Downstream P2P traffic represents about sixty percent (60%) of all bandwidth consumed. In contrast, file sharing in the UK and

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North America consumes about forty-eight (48%) of total downstream bandwidth and seventy-six percent (76%) of upstream traffic.

VI. The *MGM* v. *Grokster* Decision

In its *MGM* v. *Grokster* decision, the US Supreme Court vacated the Ninth Circuit's summary judgment that had been in favor of respondents Grokster and StreamCast. The circuit court had relied on the "Betamax Doctrine" established in the 1984 *Sony* v. *Universal* case to conclude that there had been no contributory infringement because P2P software programs Grokster and Morpheus could be used for substantial non-infringing uses.

A. Ruling Summary

The High Court remanded the case to the lower courts for reconsideration of the petitioners' motion for summary judgment, additional fact finding, and possibly a trial.

It also attempted to preserve balance while introducing a new "Inducement Doctrine" by seeking to explain that one infringes copyright in a contributory fashion by intentionally inducing or encouraging direct infringement:

"We hold that one who distributes a device with the object of promoting its use to infringe copyright, as shown by the clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties," Justice Souter wrote in the Court's opinion.

In other words, the Court attempted to clarify that while a technology in and of itself, as well as its dissemination, may qualify as "legal" generally or in the abstract, an implementation of it may become part of an unlawful "inducement of infringement" scheme if designed or executed with the intention of causing infringement.

The Court rejected the "actual knowledge of specific infringement" reading of Betamax. But it also tried to retain from Betamax that absent other evidence of intent, mere distribution of a product that has substantial non-infringing uses, even with knowledge of infringing uses should – theoretically at least – not expose a distributor to contributory liability. Beyond that, Justices seemed to lack agreement regarding the limits and applications of Betamax.

Justice Ginsburg, joined by Chief Justice Rehnquist and Justice Kennedy, favored a narrower interpretation of the Betamax safe harbor: defendants need to satisfy a relatively heavy evidentiary burden to earn such shelter. Justice Breyer, joined by Justices Stevens and O'Connor, favored a broader interpretation: the heavier evidentiary demand that would result from Justice Ginsburg's stricter interpretation of Betamax would increase legal uncertainty and risk, and would have a chilling effect on technological innovation.

B. Parties' Actions

Should the parties in *Grokster* not reach a settlement, the case, now remanded to a lower court for more fact finding, will likely result in further questions that appeals courts, including perhaps the Supreme Court, will need to answer.

According to published reports, StreamCast may further argue its case in the lower courts, while Grokster will likely exit the business by negotiating settlement terms with the major music labels and movie studios, presumably then supporting the conversion of its traffic to an entertainment industry sanctioned digital distribution service.

As reported, the music label plaintiffs have now also expanded their legal campaign against the current major P2P software developers by sending cease-and-desist letters to seven of the leading companies, including MetaMachine.

These letters threaten imminent litigation – not only against the companies, but also against their executives and directors – based on the music industry's interpretation of the *MGM* v. *Grokster* ruling unless the firms immediately take steps to eliminate infringement. The major movie studio plaintiffs last week announced a

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new thirty million dollar ($30,000,000) initiative to combat infringement through technological solutions as well as their support for the music industry's actions.

C. General Effects

Grokster's narrow holding supposedly meant that a technology firm could lose the benefit of a Betamax safe harbor if it makes a product capable of infringing and non-infringing uses but then affirmatively and repeatedly encourages users of its product to infringe. This sounds perfectly reasonable in theory. But in practice, the case has already reshaped the contours of the debate between copyright holders and developers of new technology far beyond such a supposedly intended limitation. In particular, the Court has offered no objective standard for the definition and measurement of such inducement. As a result, virtually every P2P distributor, including MetaMachine, cannot know with certainty how a court of law will judge its past actions.

The decision left undefined the specifics of a "safe harbor" for developers and distributors of new content distribution technologies, deferred difficult related issues for future cases, (perhaps inadvertently) encouraged more litigation, and made it harder to work secondary liability cases through to clean outcomes. The latest round of cease-and-desist letters and the reactions to them by the major P2P distributors prove the point perfectly.

Grokster represented a relatively easy case given what the Court viewed as clear evidence of egregious intent to induce infringement. Other cases will present harder liability questions to the extent that they present more balanced or nuanced fact patterns; in so doing they will almost certainly expose gaps, conflicts, and ambiguities in relevant legal doctrines. In particular, the case will undoubtedly come before the Court where a distributor makes no statement of "encouragement" whatsoever. I cannot resist the mental exercise: If eDonkey had simply written on its website from day one, "eDonkey is a P2P file-sharing client" would we know for sure that we had avoided "affirmatively and actively" inducing infringement? If so, then these sites will spring up immediately; if not, then the effect of *Grokster* will go beyond chilling, perhaps to the point of freezing innovation in its tracks.

Many technology companies, including eDonkey, whose products can be used for infringement will simply find themselves unable to continue operations in a Post-*Grokster* world -- not necessarily because they would lose under the new *Grokster* standard, but rather because they literally cannot afford the costs of mounting a legal defense. Companies like eDonkey must face the reality that confronting unimaginably larger opponents that can outspend small, under-funded technology companies to death makes the question of "legal" or "illegal" a moot point.

Large multinational copyright aggregators have rapidly become more aggressive in threatening lawsuits alleging secondary infringement based on inducement theories. Because the question of intent is highly fact-dependent and discovery rules will afford plaintiffs wide latitude to seek probative evidence, it will be much more difficult for defendant technology companies to win an early-phase summary judgment in these cases. The small, innovative ones will no longer be able to afford to defend themselves in the face of the far greater financial resources plaintiffs can throw into the fight.

On its face, the inducement doctrine may sound sensible, but as a practical matter this standard makes it impossible for defendant technology companies to win an early-phase summary judgment when sued for giving rise to infringement. The "Betamax Doctrine" provided a bright line rule for lawful technologies – if a new distribution technology was "capable of substantial non-infringing use," its developers and distributors could innovate without the courts looking over their shoulders; they did not have to worry about predicting the behavior of their customers. Challenges to new technologies could be wrapped up relatively quickly by applying the well-defined standards of Betamax.

Perhaps the most disconcerting argument in the Court's decision – and a good example of the massive confusion facing technology companies in the wake of *Grokster* – is one of the Court's examples that supposedly evidences the respondents' intent to induce:

> "First, each of the respondents showed itself to be aiming to satisfy a known source of demand for copyright infringement, the market comprising former Napster users. Respondents' efforts to supply services to former Napster users indicate a principal, if not exclusive, intent to bring about infringement."

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Now try to imagine the consequences. If marketing to former Napster users is evidence of intent to induce infringement, could a potential advertiser be held liable for marketing to eDonkey users? I hope not – and the Senators on the committee should hope not. During the 2004 presidential campaign, eDonkey ran advertisements for both President Bush and Senator Kerry. Perhaps they were both courting the swing "Infringement Vote?"

The *Grokster* decision blurs that bright line. By opening up the question of whether the developer or distributor of a new technology had the "intent" to "induce" infringement, the Court made sure that company e-mails, advertising, and any other evidence may now be discovered in an exhausting trial proceeding, even if the technology itself has the potential substantial lawful use.

While the incumbent entertainment companies have no obligation to evolve their business models, I strongly believe that neither should the government defend their existing models. The government does not have the expertise to predict the way in which the industry should evolve nor can it possibly control the steady march of technology. It seems highly likely that the technological advances of the last twenty years will have a tremendous impact on the way the entertainment industry does business – but the industry participants should bear the burden of figuring out what shape that takes through negotiation and competition. Imagine if the government had decided that the automobile presented an unacceptable technological challenge to the horse-and-buggy industry and introduced legislation protecting whip manufacturers.

D. Its Impact on the eDonkey Business Model

To understand the impact of *MGM* v. *Grokster* on eDonkey, one must first understand our business model.

We generate revenues in four ways: First, by distributing software and advertisements to our users; second, by selling an upgrade of the eDonkey software to our users; third, by licensing our software to other companies (such as those in the Voice-Over-IP market); and fourth, by collecting royalties on content sold through the eDonkey application. I will focus on this last point, obviously the most relevant to this hearing.

Analysts estimate the potential market for the online distribution of licensed music and movie content to reach billions of dollars. Compare that to the total revenue generated by the entire P2P industry and it becomes immediately obvious that anyone in the P2P industry would much prefer to be selling digital music than selling banner advertisements. Digital Rights Management (DRM) may – or may not – be the answer, but it seems well deserving of a legitimate opportunity to succeed. Advances in DRM and payment processing solutions have made it possible for "open" P2P environments, such as eDonkey, to support the secure distribution of licensed copyrighted works – in fact, we already do distribute independent content, as described above.

In the file-sharing environment that we envisioned, rights holders would have the DRM tools and support services to manage key aspects of every transaction – and to monetize them through a variety of means such as advertising, sponsorships, cross promotion, packaging, subscriptions, and paid downloads. In fact rights holders could control distribution not only of works they placed into P2P distribution, but also the works that consumers placed there independently. Unfortunately, before licensing content to us, the labels demanded that we control the activity of our users – something that we could not do even if we wanted to given the purely decentralized nature of the eDonkey software.

E. Two Divergent Paths

Increasingly, as a result of *MGM* v. *Grokster*, P2P development will likely progress down two separate paths.

One will be the corporate, profit-motivated enterprises, which likely will be forced to comply with contractual terms stipulated by major entertainment rights aggregators such as reverting to centralized indexed searches, implementing various types of filtering, operating closed networks, and offering conventional industry-sanctioned business models like the current centralized paid download stores and tethered subscription models.

A challenge will be to retain the "old P2P's" appeal to the consumer – as a terrific facilitator of music discovery, including some amount of free music for listening before purchasing, and for participating in a vibrant community based on sharing musical preferences.

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What may get lost or ignored in this step backwards technologically is that P2P poses a different set of risks and benefits. Because it is a different "market" for music, it may well call for a different market solution.

In previous discussions with music labels, I have often gotten the sense that they perceived themselves to be negotiating *against* me. I have always believed that conversations with the labels should sound more like partnership discussions where the content owners and the distributors collaborate to develop a product offering that will be accepted by consumers and succeed in the marketplace.

It is not that I wanted more liberal business rules solely for my benefit – if we came up with a set of business rules that we loved but the consumer did not, the consumer could simply go elsewhere – to eMule, perhaps (more on this below).

The other subset will comprise the individuals, basic researchers, hobbyists, and hackers, who will continue to explore technological advances, although probably not publicly in the United States for fear of ruinous litigation prosecuted by the entertainment industry. Undoubtedly, the next generation of open P2P applications will travel even further down the road of anonymity and secrecy. They will come with more data security (encryption) and more user anonymity than anything currently available.

This will present several problems. First, it may well provide a place for users of the current P2P applications to flee, should we be unable to persuade them to convert to the new "closed" applications. Second these users will be harder than ever to locate and it will be harder than ever to prove what files these individuals are sharing – making infringement litigation virtually impossible. Third, these applications will likely be open-source (meaning no one owns them) and will be coded by people all around the world without any accountability.

It may be worth noting that MetaMachine never sought to go down this road because we believe that these features do not further the many legitimate uses of the eDonkey software – rather, they simply aid and abet the infringing uses that we have taken proactive measures to discourage.

VII. C & D Letter

The tenor of our conversations with content owners took a turn for the worse when MetaMachine received one of the previously described cease-and-desist letters from the Recording Industry Association of America (RIAA). This threat of imminent litigation from the major music labels, coming in light of the Supreme Court's ambiguous ruling led us to conclude that, regardless of the virtue and lawfulness of our intentions and practices and our confidence that we never intentionally induced infringing activity, we did not have the resources to endure the protracted litigation that the RIAA letter presaged.

Because we cannot afford to fight a lawsuit – even one we think we would win – we have instead prepared to convert eDonkey's user base to an online content retailer operating in a "closed" P2P environment. I expect such a transaction to take place as soon as we can reach a settlement with the RIAA. We hope that the RIAA and other rights holders will be happy with our decision to comply with their request and will appreciate our cooperation to convert eDonkey users to a sanctioned P2P environment.

A. Its Impact on Innovation in the P2P World

I believe that all of the existing open P2P companies in the United States will cease operation in coming months. Instead of creating new technologies, these companies will focus their energies on imitating the well-established retail models of iTunes, Rhapsody, and the new Napster. I would hardly define that as innovation.

It's hard to imagine future "open decentralized" P2P companies opening shop as American corporations. That will be unfortunate because some of the benefits of companies operating in the U.S. are that they are easy for entertainment rights holders to access, they can be held to the contracts they sign, and they can be made available to provide input to Congress. I predict that, unfortunately, innovation in this area will come to a halt.

Note that this poses grave dangers. Perhaps the hottest P2P company (or any technology company for that matter) of the moment is Skype, which eBay recently acquired for more than two billion dollars. Where was Skype founded? Not in the United States. That represents hundreds of millions of tax dollars that will not be

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collected by federal, state, and local governments. Where are the Skypes of tomorrow being founded? Your best bet is to look offshore.

At the same time, more and more individual developers of innovative P2P applications will go offshore and underground and become harder to find. Let me share an experience MetaMachine had in fighting these unlawful developers, as it may foreshadow similar challenges that other P2P software providers, and therefore the entertainment industry, will face as they attempt to transition their current file-sharing traffic to closed online content reselling operations.

Some of you may have heard of an offshore underground P2P application called eMule. Our software's name is eDonkey, of course, not eMule. The vast majority of intellectual property attorneys from whom we sought counsel have advised us that in theory we have a good trademark infringement case against eMule's distributors (yes, we face our own problems protecting our intellectual property!) I even have plenty of proof of marketplace confusion. Few consumers understand the difference – even many technology industry insiders do not really understand the distinction. Not only have the eMule distributors adopted a confusingly similar name, but they also designed their application to communicate with our eDonkey clients using our protocol.

In other words, eMule clients basically camouflage themselves as eDonkey clients in order to download files from eDonkey users. As a result, eMule computers actually usurp some of the bandwidth that should be allocated to eDonkey file transfers, degrading the experience of eDonkey users. So, have we had any success trying to stop them? Is there any company to sue? Is there even a single official representative of eMule with whom to negotiate? No. I have no doubt the RIAA will have better luck finding them than we have, but it surely will not be quite as easy as finding me.

VIII. Issues to Consider for Potential Legislation

The Supreme Court's decision has exacerbated the protracted conflict between major entertainment companies and current-generation P2P software developers. As a result of the high Court's ruling, all sides have focused their energies on legal maneuvering rather than continuing the dialogue we started before the decision came down. Indeed, many of the incumbent P2P companies have made hasty arrangements for expedited exits either from their businesses entirely or have sought refuge outside of the United States. News reports suggest that Ares Galaxy has "open-sourced" its source code, potentially paving the way for new "darknets" to form.

P2P copyright infringement can not only be dramatically reduced, but P2P also has the potential to serve as a more robust and efficient distribution channel than its predecessors for a greater diversity of content offered in a larger variety of ways. But to do so will require leading entertainment companies, P2P software distributors, and technology solutions providers to collaborate rather than litigate or retreat from participating in fear of litigation. It will require more than vainly trying to funnel tens of millions of users into closed P2P environments unless those new P2P applications meet consumers' needs. Third-party firms need to be allowed to demonstrate that they can provide adequate safeguards and entertainment content rights holders need to license their works for P2P distribution. Beyond that, P2P can also become an advanced communications medium and collaboration platform.

I cannot fathom how many paid downloads we could have sold on eDonkey if the record labels had granted us licenses to sell their content. Imagine if P2P developers could have converted a mere one percent (1%) of all downloads that have occurred in their applications over the last eight (8) years. If we accept the entertainment industry's claims that tens of billions of P2P file transfers have occurred then we have missed out on hundreds of millions of transactions that could have – should have – been consummated.

A. Defer to the Marketplace

We believe that business and technical solutions should be encouraged in the private sector and that a request for any necessary enabling legislation should come only as a last resort and only based on a consensus among affected parties.

Global decentralization of the Internet has reached the point where it will be virtually impossible to stop the proliferation of P2P file-sharing technology or prevent its continuing evolution to higher levels of efficiency.

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The channel has already proven to provide a highly efficient medium for legitimately marketing copyrighted works through P2P applications.

I cannot predict what models will be well-received by consumers. Just as when any new product comes into the market, any viable new P2P business model must succeed in the marketplace. The consumers – not me, not the entertainment executives, and not Congress – will determine what works and what does not. In order to maximize the likelihood of converting existing P2P user bases, I urge everyone involved to be willing to experiment and take risks with different business models. I am infinitely confident in the ability of America's entrepreneurs to come up with one or more solutions that work – but it is going to take more than one bite at the apple. I sincerely hope the entertainment companies will endorse several different ideas in order to most successfully preempt the flow of existing P2P users to noncompliant rogue applications.

B. A Similar Precedent

I am not here to tell the entertainment companies how to run their businesses – indeed, I do not claim to have all the answers. But I did run a content business for three years prior to working at eDonkey. I was one of a handful of senior executives who held the title of Publisher at Barnes & Noble, Inc. As such, I was in the business of selling content and, not surprisingly, I faced many of the same challenges that the executives at the major labels and studios face today. In closing, I will share a story from my experience there – again, not because I have all the answers, but because I hope that my experience might at least illuminate the conversation we are having at this hearing.

My job at Barnes & Noble was to sell as many SparkNotes study guides – I am talking about physical, printed, books, of course – as possible. But prior to my company's joining Barnes & Noble, we had been giving this content away for free on our website. I vividly recall a meeting on one of my very first days at Barnes & Noble when my boss – a very senior executive at B&N – suggested that we either take down the website or start charging for access to the website. His rationale – perfectly logical and reasonable – was that we could not possibly sell books in our retail stores if we were giving away the same content online. I disagreed vehemently, arguing that we should use the website to drive sales of books. I do not think I actually convinced him, but he let me make the call and we kept the website free.

Sure enough, among a customer base that absolutely knew that they could get the exact same content for free from our website, sales of the physical books beat all of our expectations. I have had countless conversations since then – with journalists, professors, friends – who have asked how it could possibly happen that people would spend money to buy what they could get online, legally, for free. Of course, the answer was that the books were a slightly different product – they offered a different type of convenience and portability than the free web content did. Dasani and Aquafina are also great examples that you can compete with "free." Perhaps in the ultimate sign that our model worked, our biggest competitor, Cliffs Notes, recently began offering its content free on its website. Too little, too late, though, as by that time SparkNotes' brand recognition far exceeded that of the once venerable Cliffs Notes.

The point of this story is to provide an example of extremely liberal business rules governing the use of digital content that turned out to be highly profitable to the rights holder, in this case, Barnes & Noble. When I advocate for rules that allow users to listen to an audio file quite a large number of times for free – it is not out of any "religious" belief that content should be free. I speak from experience that you can make money by giving some content away for free.

C. Recommended Approach

There may well be no more need for legislation in light of the recent *Grokster* decision – I honestly do not know the position of the entertainment industry on this issue. To the extent that you do consider legislation, I have a few ideas on what that legislation should cover, though I will refrain from making any specific policy recommendations:

1. Clarify the Supreme Court's ruling in *Grokster*. I cannot emphasize enough how important this is to entrepreneurs. It is one thing for low wage jobs to start going overseas; it would be quite another for companies to follow Skype's lead and take their innovations offshore to avoid the ambiguities of *Grokster*.

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2. Make sure that the legislation will have the practical consequences you desire. This is more for the sake of the entertainment industry, of course. You have to assume that open source projects will grow in popularity and that data encryption and user anonymity will make it impossible to determine who is sharing what on the next generation of P2P applications. If it won't have the desired effect, then it may not be worth legislating.

3. Encourage a market solution. Tens of millions of consumers are thirsting for the content created and distributed by the major labels and studios – there will be – there must be – numerous business models that will generate immense profits from these individuals. It may be the incumbent business model or it may be a modification to that model. Or it might be a different model all together. I firmly believe that no legislation will serve us well unless it facilitates creative market solutions rather than mandates a specific outcome.

Although we have determined that we will likely not be directly taking part in the upcoming evolution of the P2P industry, MetaMachine wishes those who are continuing to address the P2P copyright infringement problem as much success as possible. We pledge our personal support to your ongoing oversight efforts, and offer whatever assistance we can provide the Committee as individual concerned citizens with respect to such efforts.

Respectfully,

Sam Yagan
President
MetaMachine, Inc.

Cc:
Orrin G. Hatch
Charles E. Grassley
Edward M. Kennedy
Jon Kyl
Joseph R. Biden, Jr.
Mike DeWine
Herbert Kohl
Jeff Sessions
Dianne Feinstein
Lindsey Graham
Russell D. Feingold
John Cornyn
Charles E. Schumer
Sam Brownback
Richard J. Durbin
Tom Coburn

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Department of Justice

STATEMENT

OF

DEBRA WONG YANG
UNITED STATES ATTORNEY
CENTRAL DISTRICT OF CALIFORNIA
DEPARTMENT OF JUSTICE

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

THE IMPACT OF THE SUPREME COURT'S DECISION IN MGM v. GROKSTER

PRESENTED ON

SEPTEMBER 28, 2005

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STATEMENT OF
DEBRA WONG YANG
UNITED STATES ATTORNEY
CENTRAL DISTRICT OF CALIFORNIA
DEPARTMENT OF JUSTICE

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING
THE IMPACT OF THE SUPREME COURT'S DECISION IN *MGM v. GROKSTER*

PRESENTED ON
SEPTEMBER 28, 2005

Introduction

Chairman Specter, Ranking Member Leahy, and Members of the Committee, thank you for this opportunity to discuss the impact of the Supreme Court's decision in *MGM v. Grokster*,[1] and, more broadly, to share with you the Justice Department's efforts in protecting intellectual property and prosecuting those who steal or illegally distribute our intellectual resources.

The timing of this hearing is particularly appropriate. Although the Department, as I discuss below, has over the past several years invested significant time and resources toward protecting this Nation's intellectual property, Attorney General Alberto Gonzales has renewed the Department's commitment to its Task Force on Intellectual Property. He also recently created an advisory subcommittee consisting of United States Attorneys who will work closely with the Task Force, the Office of the Deputy Attorney General, the Criminal Division, and various other components to implement the Task Force's comprehensive recommendations and increase our effectiveness in prosecuting cyber crime and intellectual property offenses. I am honored that he has asked me to chair this Attorney General's Advisory subcommittee and I am also grateful for this chance to address this Committee and open up what I hope will be a productive dialogue with Congress about how best to combat the misuse of our intellectual property capital.

We have placed special value on intellectual property since our Nation's birth. The Constitution itself expressly grants Congress the power to "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[2] The First Congress wasted no time implementing this

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[1]125 S. Ct. 2764 (2005).

[2]U.S. Const., art. I, § 8, cl. 8.

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Constitutional directive, and enacted the first federal law creating copyright protection in 1790.[3] Over the ensuing two centuries, Congress has time and again revised intellectual property law with a careful eye toward maintaining a proper balance between providing the incentives to create (through the mechanism of a statutory monopoly for ideas) and ensuring the ability of the public to enjoy and use the fruits of that creativity (by limiting the monopoly's duration and crafting appropriate exceptions).

The *Grokster* Decision

In fashioning the balance between private incentives and public use, Congress has traditionally extended copyright, trademark, and patent protection by statute, and relied upon private parties to police one another by allowing aggrieved parties to sue one another civilly for damages or other equitable relief. *Grokster* is one such case. In *Grokster*, the Court was called upon to determine when a person could be held secondarily liable for a third person's acts in infringing a copyright. The Court encountered the issue in *Sony Corp. of America v. Universal City Studios, Inc.*[4] Under Sony's Staple-Article Rule, a manufacturer or distributor is not secondarily liable for the design or distribution of a product that is capable of substantial noninfringing use.[5] In *Grokster*, the Court clarified that the possibility of such non-infringing use is not by itself sufficient to defeat secondary liability when the device maker intends to facilitate copyright violations: A person is secondarily liable for the infringement of others if he distributes a device with the object of promoting its use to infringe, as shown through a "purposeful, culpable" "expression or other affirmative steps taken to foster infringement."[6]

Of course, *Grokster* involved civil liability. Accordingly, it is not directly relevant to and does not directly affect the Department's prosecutorial efforts. But *Grokster* is helpful in understanding the issues that we regularly confront as criminal enforcers of intellectual property law. *Grokster* highlights one of the perpetual challenges of criminal intellectual property enforcement – namely, keeping up with the new and innovative ways in which technology is used to violate these laws. *Grokster* emphasizes the importance that a party's intent can play in assessing liability, which is entirely consistent with the invention of intellectual property law as a means of balancing competing incentives.

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[3]Act of May 31, 1790, ch. 15, § 1, 1 Stat. 1241 (1790).

[4]464 U.S. 417 (1984).

[5]*Id.* at 442.

[6]125 S. Ct. at 2780.

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Criminal Enforcement of Intellectual Property Laws

Congress has resorted to criminal sanctions as an additional means of protecting intellectual property. This innovation has been relatively recent. It was not until 1897, more than a hundred years after the first copyright statute, that Congress made it a misdemeanor to willfully infringe a copyright by publicly performing a dramatic or musical work for profit.[7] It was not for nearly another century that Congress, in 1982, created the first felony offense for willful infringement of a copyright by distributing or reproducing certain types of works (movies, audio-visual works, and sound recordings) for a profit.[8] The theft of trade secrets did not become criminal until 1996,[9] and, to this day, patent infringement is not a crime but remains subject to civil liability.

Congress' increasing reliance on criminal sanctions has coincided with the onset of the Information Age. Intellectual property is fundamental to our current economy. Every year, we export hundreds of billions of dollars of motion pictures, music, software, new technologies, and innovations in nearly every field of endeavor. Piracy and theft of that intellectual property has a substantial harmful effect on nearly every industry, from electronics to entertainment to industrial logistics. Moreover, the piracy of our intellectual property is often intimately related to the misuse of trademarks. Consumers rely on those trademarks, especially brand names, as a means of assuring themselves of the quality and safety of the goods attached to them. As a result, misuse of trademarks can endanger public health and safety as well as the economy.

In light of these important concerns, the Department has taken its mandate to enforce these carefully tailored criminal laws very seriously. As with other forms of contraband, the Department has attempted to combat illegal trafficking in intellectual property in several ways. First, we have focused on halting the "supply" of unauthorized intellectual property by deterring the initial theft of the property and its modes of distribution. Second, we have attempted to diminish the "demand" for such product through educational and other outreach programs. Lastly, we have developed a specialized cadre of prosecutors who work hard to keep abreast of the latest technological developments, educate federal agents and the public, and prosecute cases that penalize offenders and, we hope, have a publicly visible deterrent effect. I will share with you some of the specifics of our efforts, and how Congress has been a necessary and welcome ally in these endeavors.

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[7]Act of Jan. 6, 1897, 29 Stat. 481 (1897).

[8]Pub. L. No. 97-180, 96 Stat. 98 (1982).

[9]Electronic Espionage Act, Pub. L. No. 104-294, 110 Stat. 3488 (1996).

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Stopping the Supply of Illicit Intellectual Property: Theft & Distribution

Attacking the supply of the illicit market in intellectual property involves a two-fold focus: stopping the initial theft of the property and dismantling the distribution chain. With respect to motion picture piracy, for example, we have identified three ways in which movies are initially taken prior to their release for sale in DVD format. First, employees of a post-production facility hired by the studio will violate the terms of their employment and steal a copy of the movie. Second, a person with an "advance copy" of a movie will either copy or allow the movie to be copied. Persons tapped by the Academy of Motion Picture Arts and Sciences to be "screeners" – that is, to receive a copy of a movie for purposes of screening and voting – fall into this category. Lastly, moviegoers will bring a video camera and other equipment into a movie theater and surreptitiously record a movie as it is being exhibited at a premier or other advance showing.

The Department has aimed its prosecution efforts at precisely these supply sources, and my office has largely adopted a "zero tolerance" policy. The damage done by these criminals is often impossible to calculate, as it has a ripple effect that undermines consumer sales and, beyond that, the health of the various creators and the industry that supports them.

For example, in February 2004, the Department prosecuted several individuals who stole copies of movies including *The Passion of the Christ* and *Kill Bill, Vol. 1*, pre-theatrical release, from a post-production house responsible for putting the finishing touches on the films. The Department has also prosecuted and obtained convictions against many different individuals who coopted movies from screeners, including *The Incredibles*, *Friday Night Lights*, and *Finding Neverland*. Perhaps the most notorious of these screener-distributors was Russell Sprague, who pled guilty to copyright infringement in 2004, admitting to distributing over 100 screener titles that he had obtained from an Academy member who had received the screeners legitimately due to his Academy membership, which has since been revoked.

Very recently, this past June, our Office – which is home to Hollywood – obtained guilty verdicts after a two week trial against Johnny Ray Gasca, a notorious "camcorder." Subsequent to the filing of charges against Gasca, Congress stiffened the penalties for camcorders and created a separate new felony crime to address precisely this type of activity.[10] Moreover, until recently, a person who uploaded a film onto the Internet was treated much the same as a person who simply distributed a copy. This did not accurately reflect the greater degree of harm that a so-called "uploader" causes, and Congress stepped in earlier this year to make the act of uploading itself a felony, at least when the item uploaded is a motion picture not yet available for public purchase.[11]

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[10]Pub. L. No. 109-9, Title I, § 102(a), 119 Stat. 210 (2005) (creating 18 U.S.C. § 2319B).

[11]See Family Entertainment and Copyright Act of 2005, § 103 (amending 17 U.S.C. § 506 and 18 U.S.C. § 2319).

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Just last month, Department prosecutors in San Jose, California became the first in the Nation to use several provisions of this new law, known as the Family Entertainment and Copyright Act of 2005, to charge a Missouri man with felony crimes for camcording films in movie theaters and distributing the films on computer networks. This is yet another example of Department prosecutors in the field making quick and efficient use of the tools given to them by Congress to continue their fight against piracy more effectively.

Once a movie, song, software program, or game is stolen, thieves usually opt for one of two ways of distributing the pirated goods. The first, and most widespread, form of distribution is over the Internet. Online piracy involves several steps – the person who "uploads" his or her copy of the movie, program, or other work to a server, the person who removes any copy-protection devices embedded in that copy, and the person who facilitates its distribution.

The person who removes any copy-protection device, often called a "cracker," faces criminal liability under the Digital Millennium Copyright Act ("DMCA") for circumventing that device.[12] The Department has been careful to exercise its prosecutorial discretion in such a way to charge those DMCA cases against crackers who are part of distribution chains. For example, in early 2003, a Vacaville, California man was sentenced to two years in federal prison for his part in creating more than 4,500 bootlegged video tapes by means of a movie videocassette reproduction lab, with a vast array of equipment hooked up to manufacture counterfeit movie videocassettes and labels. The bootlegger was also charged and convicted under the DMCA for using equipment in the reproduction lab which bypassed the copyright protections built into the videocassettes.

In another example of charges brought under the DMCA, in the fall of 2003, my office obtained the first ever conviction by jury in a DMCA case, related to the circumventing of DirecTV security measures to reprogram DirecTV access cards, also known as "smart-card hacking." A total of 17 defendants were charged in Operation Decrypt, an undercover FBI investigation that targeted high-level computer programmers and hardware manufacturers who distributed software and devices used to steal satellite services from DirecTV and DISH network.

Distribution of copyrighted works over the Internet often takes one of two forms – centralized and de-centralized. The most common form of centralized distribution we have encountered is the so-called "warez group." A warez group is a loose confederation of individuals who maintain a massive database, often containing terabytes of data comprised of illegally pirated movies, software, music, and games. Members join the group by contributing pirated works, and then are granted privileges to download other pirated works from the group's central database. The Department has aggressively infiltrated and taken down several of these warez groups.

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[12] 17 U.S.C. §§ 1201-1204.

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Among our more prominent recent prosecutions of warez groups is "Operation Site Down." In June 2005, the Department and law enforcement from 10 other countries executed over 90 searches worldwide targeting many of the leading criminal warez groups, including RisCISO, Myth, TDA, LND, Goodfellaz, and Hoodlum. The takedown was orchestrated by the Computer Crime and Intellectual Property Section ("CCIPS") at Main Justice, which coordinated the unprecedented international coordination in this global enforcement effort, with assistance from the U.S. Attorney's Offices in various cities around the Nation. The investigation was headed up by FBI Field Offices and the U.S. Attorney's Offices in Charlotte, Chicago, and San Francisco. We estimate, conservatively, that more than $50 million in intellectual property was recovered.

De-centralized distribution over the Internet involves "peer-to-peer" ("P2P") networks similar to those involved in the *Grokster* decision. Unlike more centralized networks that house all of their pirated intellectual property in a single location or in a small handful of locations, P2P networks can operate by using space on members' computers; members may obtain pirated items by accessing one another's computers rather than any centralized database. We are aiming our efforts at the organizers of these groups reproducing and distributing copyrighted works.

Distribution of intellectual property not only takes place on the Internet, it also takes place in what we sometimes call the "real world." We have seen that this second type of distribution network obtains pirated copies of movies, music, games, and software, then reproduces hard copies of them, for sale at retail stores and swap meets, and on street corners all around the United States. This type of crime often involves both copyright and trademark infringement, at least where the pirated goods are contained in packaging that uses the logos and brand names of software companies, movie studios, game producers, or music distributors. The Department has aggressively prosecuted this type of distribution network as well.

Our recent efforts in both of these areas include:

* ***Operation D-Elite.*** In May 2005, FBI and Immigration and Customs Enforcement ("ICE") agents executed search warrants at 10 locations across the United States targeting leading members of an international P2P network known as the Elite Torrents (due to their use of the program BitTorrent). CCIPS is leading this ongoing investigation and prosecution, the first of its kind to target the misuse of the P2P software platform BitTorrent.

* ***Operational Digital Gridlock.*** In August 2005, the FBI executed six search warrants in three different States aimed at dismantling another misused P2P network. Two of the defendants pled guilty, the first convictions for piracy using a P2P network. The United States Attorney's Office in the District of Columbia and CCIPS have handled this prosecution.

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* ***Operation FastLink.*** In April 2004, the Department, in conjunction with the authorities in Belgium, Denmark, France, Germany, Hungary, Israel, the Netherlands, Singapore, Sweden, and Great Britain and Northern Ireland, executed 120 search warrants simultaneously against a criminal operation that manufactured pirated copies of movies, software, games, and music. Thus far, we have obtained 15 felony convictions and are continuing to press forward against other possible targets. This investigation was orchestrated and led by CCIPS and used the network of U.S. Attorney's Offices around the Nation.

* ***Operation Digital Marauder.*** Last year, U.S. Attorney's Offices in California and Washington State concluded an undercover operation for more than a year and executed several search warrants aimed at an organization that was engaged in mass production and subsequent distribution of pirated and counterfeit software in Los Angeles, San Francisco, Vancouver, and Texas. A total of 12 individuals were charged with copyright and trademark violations in one of the largest counterfeit software cases ever charged.

As is evidenced from these cases, the theft and distribution of intellectual property almost always has an interstate – and often an international – dimension. In October 2004, USTR and the Departments of Commerce, Homeland Security, and Justice announced the Administration initiative called the Strategic Targeting Organized Piracy ("STOP") to combat trade in pirated and counterfeit goods. Other participants include the Department of State and the Department of Health and Human Service's Food and Drug Administration. This White House-driven, interagency initiative targets cross-border trade in physical/tangible goods and has five general components:

* Stopping infringing and counterfeit goods at the U.S. border by improving identification and seizure capabilities;

* Dismantling criminal enterprises that steal intellectual property;

* Keeping counterfeit and infringing goods out of the global supply chain;

* Empowering U.S. businesses to secure and enforce their intellectual property rights at home and abroad; and

* Reaching out to U.S. trading partners and building international coalitions to block trade in infringing and counterfeit goods.

As part of its contributions to the STOP initiative, the Department has continued to target international, large-scale criminal organizations that steal and trade in pirated and counterfeit goods. One example was the global enforcement action knows as Operation Site Down, which I referenced earlier. In addition, in April and June of this year, the Department accompanied other

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STOP agencies on foreign trips to Hong Kong, Korea, Singapore, France, Belgium, Germany, and the United Kingdom to heighten awareness of IP enforcement concerns and build effective coalitions with like-minded trading partners to block trade in pirated and counterfeit goods.

Also in the international arena, the Department has enhanced and improved its delivery of intellectual property training programs for foreign prosecutors and investigators by developing key relationships with foreign officials directly responsible for intellectual property enforcement. For example, the Department has worked closely with Mexican authorities, particularly intellectual property prosecutors and customs officials, to enhance intellectual property enforcement efforts in the hopes of stemming the flow of pirated goods between the two neighboring nations. Similar efforts are underway in Panama and are planned in several Eastern European and Southeast Asian countries known for producing pirated and counterfeit goods.

The Department has also taken an active role in seeking greater criminal enforcement of intellectual property violations in China. U.S. and Chinese law enforcement officials had extensive discussions on criminal enforcement of intellectual property rights and areas for potential cooperation during the U.S.-China Joint Liaison Group meeting held in February 2005. The Joint Liaison Group has provided a productive forum for U.S.- China law enforcement cooperation in a number of areas of criminal enforcement, and we are hopeful that we will be able to make progress on intellectual property protection in China through this specialized law enforcement forum.

Diminishing the Demand for Pirated Goods

In the digital age, pirated movies, music, games and software are tempting to those more interested in obtaining entertainment than obeying the law. Usually, pirated intellectual property is available for free and, in the digital age, is often identical in quality to the original. Persons inclined to pay for such intellectual property may decide to take the expedient route instead and download a pirated copy or buy a copy on a street corner for a small fraction of the retail cost of the authentic version.

The Department has taken an active role in educating the public, and especially the younger consumers who are often associated with accepting the fruits of piracy, about the costs of piracy to the copyright holder and to the economy. Last fall, the Department, working in conjunction with the Motion Picture Association of America and others, hosted the first "Activate Your Mind" conference in Washington, DC. High school students from the surrounding area were invited to Main Justice to hear from songwriters, a convicted felon, and others about why they should not engage in piracy; the day-long event concluded with the students preparing public service announcements denouncing music piracy. This spring, we hosted a similar event for high school students in the Los Angeles area, and focused the presentation on movie and television piracy.

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Specialized Prosecutors, Community Outreach

Since 1991, the Department has recognized that the most effective tool for combating intellectual piracy is a well-trained staff of prosecutors. Toward that end, the Department created CCIPS, a centralized unit of 35 attorneys who work from Main Justice to coordinate and support cybercrime and intellectual property investigations handled by line prosecutors in the field. CCIPS also prosecutes its own cases, and specializes in multi-district, international prosecutions. In 1994, the Department created what is now called the "CHIP" program, short for Computer Hacking and Intellectual Property. Each of the 94 United States Attorney's Offices has at least one prosecutor who receives training and is a point of contact for any cases involving cyber or intellectual property crime. Now, 18 offices have CHIP units – that is, a group of prosecutors who specialize in these types of crimes. In recent years, our focus has shifted more than ever toward intellectual property crimes. These CHIP prosecutors receive regular training, develop important expertise, and focus their efforts on intellectual property and cybercrime prosecutions to form a strong network throughout the country to fight the increasing problem of intellectual property theft in the digital age.

These prosecutors carry their training forward. In Los Angeles, for example, prosecutors in my office hosted a training session on intellectual property law for more than 65 federal agents in February 2005. These prosecutors also engage in outreach aimed at the most likely victims of intellectual property theft, educating them about how to prevent such theft, what sorts of conduct qualifies as criminal, and what sort of evidence to preserve for purposes of criminal investigation.

In addition, last year, then-Attorney General Ashcroft commissioned the Intellectual Property Task Force. The Task Force spent six months conducting a comprehensive review of how the Department protects intellectual property rights. The Task Force consulted prosecutors and agents in the field, met with representatives from the victim industries most affected by piracy, and assessed what has been accomplished, what needs to be accomplished, and how to meet those needs in the future. The Task Force issued a written report last October, detailing its findings and making dozens of recommendations. Attorney General Gonzales, within a few weeks after taking office, re-commissioned the Task Force to implement all of the recommendations contained in the report. Some of those accomplishments include:

* Creating five new Computer Hacking and Intellectual Property ("CHIP") Units in the U.S. Attorney's Offices in Nashville, Orlando, Pittsburgh, Sacramento, and Washington D.C., bringing the total number of specialized prosecutorial units to 18.

* Providing foreign and state-side training programs on intellectual property enforcement for government officials from Brazil, Brunei, Cambodia, Chile, Colombia, Indonesia, Korea, Philippines, Malaysia, Mexico, Myanmar, Singapore, Thailand, and Vietnam.

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* Executing agreements to implement obligations of US/EU Mutual Legal Assistance and Extradition Agreements that ensure cooperation regarding intellectual property crimes with Belgium, Finland, Spain, Sweden, the United Kingdom, France, the Netherlands, Luxembourg, Lithuania, Denmark, Ireland, Portugal, and Austria; and completing or nearly completing negotiations with Estonia, Germany, Greece, Hungary, Italy, Cyprus, and Slovenia.

* Working with Congress to achieve the following legislative accomplishments:

    * legislation recognizing passive sharing of copyright works, as enacted in the Family Entertainment and Copyright Act, S. 167, on April 27, 2005;

    * legislation recognizing the premium value of copyrighted works before they are released to the public, as enacted in the Family Entertainment and Copyright Act, S. 167, on April 27, 2005; and

    * legislation allowing law enforcement officials to seize material and equipment used to make counterfeit products and labels, as enacted in the Anti-Counterfeiting Amendments of 2004, H.R. 3632, on December 23, 2004.

Concluding Remarks

As you can see, the Department takes the protection of our Nation's intellectual property very seriously. The Task Force, and the subcommittee which I have recently been asked to coordinate, will continue to grapple with the issues of how best to address both the current and emerging issues in this area. Among others, we are examining whether there are any gaps in the arsenal of criminal enforcement tools, whether the Department's prosecutorial and policy resources are distributed efficiently, and what more we can do to educate the public and potential victims to stave off the problem in the first place. I look forward to working with you on these issues in the coming months, and to sharing with you the results of our efforts as we move forward to protect the intellectual property assets that the Constitution, more than 200 years ago, recognized as a powerful asset of our Nation's heritage.

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