

MGM v. GROKSTER

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

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JULY 28, 2005
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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

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MGM v. GROKSTER

THURSDAY, JULY 28, 2005

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 2:34 p.m. in room SR-253, Russell Senate Office Building, Hon. Ted Stevens, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. TED STEVENS, U.S. SENATOR FROM ALASKA

The CHAIRMAN. This afternoon, we want to examine the issues related to the MGM-Grokster decision and the appropriate balance between copyright protection and communication innovation.

The Supreme Court decision cleared the way for peer-to-peer and other communication technologies to be liable for contributory or vicarious copyright infringement. Going forward, we'll all have to balance the competing interests of encouraging innovative services like peer-to-peer that spur new services, jobs, and economic growth against protecting content providers from piracy to ensure return on investment and continued innovation in the content space.

Now, I know it's a very controversial subject we're dealing with this afternoon, and we have a series of witnesses here.

First let me turn to our Co-Chairman, Senator Inouye.

STATEMENT OF HON. DANIEL K. INOUE, U.S. SENATOR FROM HAWAII

Senator INOUE. I thank you very much, Mr. Chairman, for holding this hearing on the Supreme Court's recent decision. As we all know, it was unanimous. It's unusual in Washington these days to get a unanimous decision on anything, especially an issue as important as copyright.

In my view, the Supreme Court has struck the proper balance between protecting the rights of copyright holders and creating an environment for technological innovation, and, in doing so, has made the American consumer the ultimate winner. With its ruling, the Supreme Court has sent an important message that the law does not allow companies to induce others to steal.

Given that millions of Americans have downloaded or swapped files using peer-to-peer technology, the Department of Justice observed that it appears many people have come to view piracy over peer-to-peer networks as different and less objectionable compared to stealing a physical copy of a CD or DVD from the store. By holding companies that promote copyright infringement by clear expres-

sion or other affirmative steps taken to foster infringement, the Supreme Court has made it very clear that stealing is unacceptable.

The recording industry, motion picture, and computer software industries are key components of our Nation's economy. According to a recent study by the International Intellectual Property Alliance, the copyright industries are strong and growing. In 2002, these industries accounted for 6 percent of the gross domestic product and employed 4 percent of the workers of the United States. In addition, these industries recorded more than \$89 billion in foreign sales and exports in 2002, which is well ahead of other major industry segments.

Given the importance of these industries by our economy, I applaud the Supreme Court's decision to hold persons accountable for actions that encourage unlawful behavior.

And so, I thank you, Mr. Chairman, for holding this hearing.

The CHAIRMAN. Thank you very much.

Senator Pryor, do you have a statement? Do you have a statement, Senator?

Senator PRYOR. I don't, thank you.

The CHAIRMAN. Thank you very much.

Just so the record will disclose the extent of this conflict, I'm going to put into the record the *Billboard* editorial of July 16 by Fred Goldring.

[The information previously referred to follows:]

Billboard Magazine—July 16, 2005

AFTER GROKSTER, CAN MUSIC BUSINESS SAVE ITSELF?

By Fred Goldring

Last week, the Supreme Court handed down a decision in the *MGM vs. Grokster* case that the news wires immediately heralded as a "sweeping victory" for our industry. Then, of all people, former Recording Industry Assn. of America head Hilary Rosen spoiled the party, pointing out that while the ruling "maybe [sic] important psychologically, it just won't really matter in the marketplace." She clarified that "knowing we were right legally really still isn't the same thing as being right in the real world."

Then *The New York Times* piled on, insisting that "[h]owever valid the industry's desire to protect its products, trying to stop file sharing has become a Sisyphean exercise." Rosen got the last word in that story, too, calling the Grokster decision "meaningless."

Next, a *Los Angeles Times* piece suggested that the recording industry might try making MP3 music legitimately available rather than trying to sell files "that restrict copying, deter sharing and limit portability." People in our industry found this last suggestion "outrageous." It reminded me that I made a similarly outrageous suggestion—nearly 2 years ago—in a piece I wrote for these pages, "Abandon the 'Shock and Awe' Tactics: An Eight-Step Recovery Program for a Healthier Music Industry."

At the time, the recording industry had initiated the first few hundred of what would become a monthly round of John Doe lawsuits filed against accused music uploaders. I posited that the strategy of suing customers (thieves) and building ever-better locks for CDs and digital singles simply was not working, and that everything we had done thus far had in fact made the problem much worse.

Sales were down. File swapping was up. Alarmed by our strategic direction, I wrote as someone who earns his living working with musicians, record companies and publishing companies (and as a musician myself) that an industry intervention was needed, to offer "tough love" as one would to "a good friend or family member who is not thinking clearly, hell-bent on a collision course of self-destruction."

In 2003, I suggested a few immediate steps that would put us on the path to recovery, specifically:

- Admit you're powerless. File sharing is not going away. Downloading is already more popular than the CD.
- Give up on anti-piracy technologies—they don't work.
- Stop attacking your own customers. (Bad PR, worse business.)
- Focus less on finger-pointing and more on immediate, practical, fair solutions.
- Give the people what they want, even if it requires that laws be changed.
- Support initiatives that will allow unlimited access to every piece of music in the MP3 format whenever and wherever someone wants it, with no conditions or restrictions, in an easy-to-use interface. People will pay for this.

Glancing over my tough-love recommendations of 2 years ago, I have to point out the obvious: 2005 sure looks a helluva lot like 2003. The cynic in me would almost think that the industry had read my suggestions and decided to do the exact opposite.

So now, we are far worse off, even perhaps to the point of no return. And we are busy celebrating the “mother of all Pyrrhic victories” when file sharing is at an all-time high.

This is not just the latest in a long history of missed opportunities for our business. It is truly a defining moment.

It is no accident that *The New York Times*, *Los Angeles Times*, *Newsweek* and *Reuters* are reporting that the music industry emperor is not wearing any clothes. Business is down another 8 percent this year, and we have pinned our hopes again on the deus ex machina. The industry has received its long-awaited vindication on paper by the U.S. Supreme Court, and yet the pundits—even Rosen (who ironically originally led this charge)—insist we are tilting at windmills. We are finally out of practical options, because there is no higher authority to appeal to.

Two years ago, I ended with this simple recommendation: “Stop your futile efforts to change the behavior of millions of music fans. Spend all your efforts on designing a system that gets everyone paid around the overwhelming behavior that exists.”

Today, I'm asking the hard questions: Will the recording industry save itself? Or are we too far gone? Is there a realistic scenario for withdrawal, a retreat from the “lawsuits and locksmiths” mentality and a swift about-face? Can we swallow our pride and prevail over hubris long enough to embrace the real world and the real market opportunity? Or is The Motley Fool correct in predicting a not-so-distant future when “the major labels won't be the same batch of old-school vinyl-pushers . . . the real power brokers in the music industry will be Google, Yahoo! and Microsoft?”

Wall Street analysts and the mainstream press do not like our prospects, and so more than ever I fear we are living in a bubble and kidding ourselves about this war and the definition of winning.

Two years ago I advocated change, and 2 years later I see status quo. So now I can only envision a frustratingly bleak future where we publicly celebrate shutting down a few peer-to-peer businesses like Grokster, though like shuttering Napster, doing so will be a useless exercise. I envision us marking 500 million songs sold in the course of a couple of years at Apple Computer's iTunes Music Store, remaining blind to the reality that (even the RIAA admits) nearly 3 billion free MP3s are swapped every month. I envision us continuing to hold out hope for a turning of the tide, an improvement in our position and a validation of our strategy that, like a desert oasis shimmering on the horizon, is always just 2 years away.

It turns out I was right in 2003. Going forward, I hope I am wrong. Because we don't have another 2 years.

Fred Goldring is a founding partner of Goldring, Hertz & Lichtenstein, a Beverly Hills, California-based entertainment law firm.

The CHAIRMAN. We have, as witnesses this afternoon, a series of people that we've selected to try and bring a balance in terms of the comments on this issue. First is Adam Eisgrau, Executive Director of P2P United.

May I call on you, please, sir?

**STATEMENT OF ADAM M. EISGRAU, EXECUTIVE DIRECTOR,
P2P UNITED, INC.; ON BEHALF OF THE ELECTRONIC
FRONTIER FOUNDATION (EFF)**

Mr. EISGRAU. You certainly may. Thank you, Mr. Chairman.

Good afternoon, Mr. Chairman, Co-Chairman Inouye, Senator Pryor. I thank you for the opportunity to appear here today on behalf of P2P United and the Electronic Frontier Foundation.

For the record, I am not, and do not, appear here today as counsel for any individual or company.

We appreciate the Committee's prospective focus, Mr. Chairman, on the larger policy implications of the Supreme Court's decision in *MGM v. Grokster*; most particularly, how to continue to promote technology, including peer-to-peer technology and technological innovation. I'm pleased to underscore that the value and legality of P2P technology, itself, was expressly recognized by the court in its opinion. Clearly, however, the misuse of this powerful and neutral communications technology continues to pose significant challenges. Notwithstanding a massive and ongoing campaign of lawsuits against consumers—11,000, and counting—the unvarnished facts are that new open peer-to-peer software programs will, and should continue to be, lawfully produced every day around the globe. And, as reported last month in *Rolling Stone*, “The lawsuits have failed to stop, or even slow, illegal file sharing.” As a practical matter, the high court's recent decision will not alter this landscape at all.

Ms. Hillary Rosen, Mr. Bainwol's predecessor at the RIAA wrote, the day before the Court's recent ruling, and I quote her, “It is said that the Supreme Court's decision will be one of the most important copyright cases ever on the books. I think it has all the makings of being famous,” she said, “for another reason. It just won't really matter in the marketplace. So, here is the crux of the problem,” as Rosen explained, “P2P services have traffic at a rate 40 to 50 times the traffic of legitimate sites. This volume needs to be embraced and managed because it cannot be vanquished. And a tone,” Ms. Rosen continued, “must be set that allows future innovation to stimulate negotiation and not just confrontation.”

Editorializing in *Billboard Magazine* on July 16—and I thank you for placing that in the record, Mr. Chairman—prominent music industry attorney Fred Goldring felt compelled to reiterate advice he had given his industry in 2003, “Stop your futile efforts to change the behavior of millions of music fans. Spend all your efforts on designing a system that gets everyone paid around the overwhelming behavior that exists.”

We fully agree, Mr. Chairman, with both Ms. Rosen's and Mr. Goldring's bottom lines and urge the Committee, therefore, to take a proactively pragmatic view of how to help the market move forward.

We have two requests. First, bring all relevant stakeholders together in a series of meetings or hearings to intelligently and civilly discuss the possibility that a system of voluntary—and I do emphasize “voluntary”—collective licensing may be a useful mechanism, among others, to help meet consumer demand for online music while also encouraging innovation and maximizing the compensation of music copyright owners, both big and small.

A similar system has, in fact, already worked well for decades, Mr. Chairman. Songwriters originally viewed radio exactly the way the music industry today views many P2P users, as pirates. Ultimately, however, they formed ASCAP, and, later, BMI and SESAC. Under this voluntary licensing system, radio stations pay a fee and, in return, get to play whatever music they like, using whatever equipment they feel works best.

Today, the performing rights societies, like ASCAP, BMI, and SESAC, pay out literally hundreds of millions of dollars annually to their artists, and virtually all eligible rights-holders opt to participate. Some difficulties over time notwithstanding, there is no question that the system that has evolved for radio is far preferable to the songwriter's original strategy of trying to sue radio into extinction.

But there is a catch, Mr. Chairman. The entertainment industries, I'm sorry to say, have unilaterally declared any kind of collective licensing for P2P, even voluntary systems, to be an absolute nonstarter, and have refused multiple invitations to discuss the concept systematically in any forum. Without passing or changing any laws, therefore, this committee has the power to do consumers, and potentially the economy, a great service by simply convening such talks under its auspices and making clear that it expects invitees to participate in good faith.

Second, for reasons detailed in our written testimony, we also ask that this committee initiate an inter-committee process meant to produce targeted statutory reform that will insulate technology innovators from potentially astronomical and crippling statutory damages under secondary liability doctrines made murkier by the court's recent ruling in *Grokster*. Originally designed to deter large-scale direct copyright infringers and other true commercial pirates, statutory damages of up to \$150,000 per work infringed can now be imposed on individual inventors, technology companies, or even venture investors without proof of economic harm. This can, and we believe should, be changed without depriving copyright owners of powerful injunctive remedies and, potentially, very large actual damages awards in secondary liability cases, or, for that matter, of continued access to statutory damages in cases of real commercial piracy.

We appreciate the opportunity to be here, Mr. Chairman. We thank you for placing the material in the record. And I look forward both to the Committee's questions and its ongoing direct involvement in these issues.

Thank you.

[The prepared statement of Mr. Eisgrau follows:]

JOINT PREPARED STATEMENT OF ADAM M. EISGRAU, EXECUTIVE DIRECTOR, P2P UNITED, INC.; AND FRED VON LOHMANN, SENIOR IP ATTORNEY, ELECTRONIC FRONTIER FOUNDATION (EFF)

Good afternoon, Chairman Stevens, Co-Chairman Inouye and members of the Committee. Thank you, and your staffs, for the opportunity to participate in these proceedings.

My name is Adam Eisgrau. I am a Vice President of Flanagan Consulting (established by former Congressman Michael Flanagan), and I appear before you today both as Executive Director of P2P United and on behalf of the Electronic Frontier Foundation (EFF), which co-authored this testimony.

P2P United was founded 2 years ago this month as a resource for legislators, other policymakers and the media in need of accurate information regarding peer-to-peer software (P2P) and its tremendous potential. Our members include the developers of the Grokster and Morpheus software programs at issue in the Supreme Court's recent decision which has brought us together today. Much more about our group and its work is available online at www.p2punited.org. The Electronic Frontier Foundation, as detailed online at www.eff.org, was established 15 years ago this month to defend the public's right to think, speak, and share ideas using all manner of new technologies, particularly the Internet and World Wide Web.

In the four weeks since the Supreme Court's ruling in *MGM v. Grokster*, many pundits, analysts and advocates have concluded that the Court's unanimous opinion obviated any necessity for Congressional action to address the issues before the Court. P2P United and the Electronic Frontier Foundation respectfully disagree for reasons articulated by the Court itself. As a unanimous Court observed at the very outset of its legal analysis in *MGM v. Grokster*: "[t]he more artistic expression is favored, the more technological innovation may be discouraged; the administration of copyright law is an exercise in managing the tradeoff." *MGM v. Grokster*, 545 U.S. 125 S. Ct. 2764, 2770 (2005).

The task of striking the right balance, however, is constitutionally delegated to Congress. Congress now has an important opportunity—indeed an ongoing responsibility—to examine the balance between copyright law and innovation with an eye toward affirmatively *protecting* and *promoting* the kind of technological innovation in communications that has been responsible for advancing our society and our economy so dramatically in the Internet Age.

Accordingly, as this committee monitors the import and impact of the Court's ruling—which we applaud it for doing today and hope that it will continue to do regularly for some time to come—our organizations urge the Committee's members to adopt a *de facto* policy of "proactive pragmatism" in the public interest. Specifically, P2P United and EFF urge the Committee to affirmatively embrace two overarching public policy goals:

- 1) proactively protect communications technology innovators from the likely chilling effects of potentially crippling liability in the uncertain legal environment created by the Supreme Court's holding; and
- 2) pragmatically promote new marketplace solutions that move us toward a world where Internet users can obtain licenses that give them lawful access to the broadest variety of copyrighted material using the most efficient and convenient technologies available.

In particular, we propose that the Committee convene and task all relevant stakeholders with exploring—merely publicly discussing in good faith—the potential of a *voluntary* "collective licensing" system for music to fairly compensate all rightsholders for currently unlawful and unpaid downloads. Significantly, such a system would profit not only the four (soon to be three) megalithic overseas corporations that control much of the world's commercial music, but also for the first time would empower and compensate the thousands and thousands of individual musical performers and writers now unaffiliated—and statistically unlikely at any point to become affiliated—with what Joni Mitchell aptly called the "star maker machinery of the popular song."¹

I. Given the Uncertainties Left by the Supreme Court's Decision in *MGM v. Grokster*, Disproportionate Statutory Liability for Secondary Copyright Infringement Will Chill Innovation if Not Congressionally Reformed

(A) Clarity about Confusion: The Consequence of the Court's Ruling

In *MGM v. Grokster*, the question asked by the parties and dozens of *amici* was direct and critically important: "When will a technology vendor be held secondarily liable for the direct copyright infringements committed by third parties using its products?" Asked specifically to clarify the reach of copyright law's existing secondary liability doctrines of "contributory" and "vicarious" liability,² the Court instead announced a new doctrine called "inducement," holding 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." *MGM v. Grokster*, 545 U.S. 125 S. Ct. 2764, 2771 (2005).

While the new doctrine of inducement presents its own uncertainties for prospective litigants and lower courts to grapple with in the years to come,³ P2P United and EFF believe that the more significant prospective difficulty for technology

innovators and investors now lies in the continued uncertainty surrounding the traditional copyright doctrines of contributory infringement, on which the Court was deeply split,⁴ and vicarious liability, on which it was essentially silent.⁵

For many years, technologists and their financial backers relied on what seemed to be a relatively “bright line” test for secondary copyright liability announced in the Supreme Court’s landmark “Betamax” ruling in 1984.⁶ Unfortunately, the spate of litigation launched against P2P companies since 1999 has muddied the waters, with the rulings in the *Napster*, *Aimster*, and initial *Grokster* cases charting different courses though each of three branches of secondary liability.

The Supreme Court’s opinion now leaves technology companies, their attorneys and their backers to pick their way through a dangerous minefield of legal uncertainties profoundly antagonistic to economic progress and deeply hostile to continued innovation. Even if they assiduously avoid so much as the appearance of “inducing” copyright infringement, America’s innovators must still guess as to whether or when they might be held liable for distributing a multipurpose electronic device or software program.

Moreover, not only *can* they still be sued under either or both of the doctrines of contributory infringement and vicarious liability, but history tells us that they probably *will* be sued. That’s exactly what happened as the first VCR and the first digital audio tape recorder came to market. More recently, ReplayTV was sued in 2001 for their improved digital video recorder because, according to the then-CEO of the Turner Broadcasting System, commercial skipping by consumers constituted “theft.”⁷

Even as the Committee meets today, entertainment industry executives are making threatening statements about the latest electronic marvel. Called the Slingbox, the device and its associated software will enable you to watch your TV programming from wherever you are by turning virtually any Internet-connected computer into your personal TV.⁸

(B) Remedy Remediation: A Measured and Targeted Solution

P2P United and EFF do not propose that the Commerce Committee undertake to rewrite the doctrines of secondary copyright liability. We do believe, however, that there is one sphere in particular in which Congress can and should act in a targeted fashion to reduce the chilling effect on innovators of ongoing uncertainty in this area of the law.

Almost uniquely in American jurisprudence, our copyright laws permit a plaintiff in an action for infringement to opt out of actually proving the extent to which they were harmed by copyright infringement in favor of receiving so-called “statutory damages.” Under Section 504(c) of U.S. Code Title 17, anytime up to the moment that judgment is handed down, the plaintiff may invoke its rights to collect (in the court’s discretion) between \$750 and \$150,000 for every *individual* copyrighted work infringed. This legal regime makes good sense when brought to bear against a commercial pirate making and selling millions of counterfeit music CDs, for example. It may well be dangerously counterproductive, however, if applied in secondary liability cases to a technology company that makes electronic products used by millions of consumers over whom the companies have no control.

This danger is especially sobering when made concrete. Apple initially promoted its phenomenal iPod with an extensive ad campaign exhorting the public to “Rip, Mix & Burn” and 1,000,000 iPods were sold in its first 20 months on the market even though it worked only with Apple’s own Macintosh computers! As of the beginning of this month, Apple had reportedly sold over 21 million iPods since the first calendar quarter of 2002.⁹ Even the earliest version of the device could store well over 1,000 songs and the largest, with a 60GB drive, now holds upwards of 15,000 songs.

At even the minimum \$750 per infringing song, and a now paltry 1,000 songs per device sold to date, it is thus a mathematical fact that—under contributory infringement, vicarious liability, or “inducement” theories—Apple still could be sued for statutory damages in excess of \$15 *trillion* for its users’ allegedly unlawful copying of music! We do not suggest that this result is likely, but the fact that it is even legally possible should be profoundly troubling, to say the least.

Faced with potentially crippling statutory liability, what will the next generation of garage inventors, like Apple’s own founders, or their possible investors choose to do with their as-yet-uninvented breakthrough devices? What price will our economy pay for highly rational risk-aversion on the part of young geniuses, their expert counsel, and savvy investors?

Most critically, is the somewhat extraordinary status quo with respect to available statutory damages really where the balance between protecting intellectual property and encouraging innovation and economic growth should be struck?

EFF and P2P United believe that the answer to this last inquiry should and can be a resounding “no.” We respectfully urge you and Co-Chairman Inouye to lead a collaborative committee (and inter-committee) process designed to produce a meaningful copyright statutory damages clause in the current Congress. Specifically, we request and recommend that statutory damages be limited by law to cases of direct copyright infringement as perpetrated by commercial pirates, and thus made expressly unavailable in cases involving secondary liability (including those brought under the Court’s new inducement test). We respectfully submit, that such reform would strike the appropriate balance that today’s hearing was expressly designed to illuminate.

On the one hand, it would still permit copyright owners to obtain both injunctive relief and actual damages, thus putting them in the same position as litigants under most other areas of common law. On the other, corporate and individual technology innovators and investors once again would be able to make reasonable business decisions about manageable levels of legal risk, rather than face the all-too-real specter of corporate capital punishment in an unpredictable legal environment. The real beneficiaries of such a balance, of course, will be American consumers, the Nation’s economy and, ultimately, copyright owners whose fortunes also depend on new technologies (their many attempts to kill them in the cradle notwithstanding) to create new and market-making business opportunities.

II. The Supreme Court’s Ruling in *MGM v. Grokster* Will Have Virtually No Practical Effect on the Digital Downloading of Music, but Congress Can and Should Take Rational, Non-Statutory Steps Now to Maximize the Potential of Peer to Peer Technology for all Music Rightsholders

(A) Lawsuits and Traditional Licensing are Poor Instruments of Public Policy

In the past 2 years, the digital music marketplace has seen significant activity and change. However, it simply cannot be credibly argued that the music industry has *not* experienced—and continues to face—an enormous failure of both imagination and the market for licensed digital downloading.

To be sure, the four companies that control 90 percent of the current music “catalog” have licensed a relative few new services to distribute what mostly amounts to presently popular music online. Apple’s iTunes, for example, recently celebrated the 500,000th a la carte download of a \$0.99 song. Moreover, in that same period, the Recording Industry Association of America has brought over 11,000 lawsuits against individuals accused of illegal downloading and, if present trends continue, will collect more than \$36 million in settlement of those claims.¹⁰

The music and movie industries have spent millions more to otherwise educate the public that such downloading is wrong and has serious consequences, both for downloaders, and for artists and copyright holders, not compensated for their works. Not incidentally, P2P United—as an organization and through its individual members’ websites—also has done its best to get out that message while our members also affirmatively promote the work of independent artists who have embraced P2P distribution of their music. Certainly not least of course, the entertainment industries have now obtained a unanimous ruling from the Supreme Court which after further litigation, they hope, will shutter the doors of P2P United’s members and dissuade other software developers from inventing even more efficient peer-to-peer programs.

As the June issue of *Rolling Stone* magazine put it, however, “One thing is clear: The lawsuits have failed to stop, or even slow, illegal file-sharing.”¹¹ Indeed, the unvarnished fact is that peer-to-peer usage is much more widespread than it was a year ago and well more than double what it was this time in 2003. According to the most recent independent analysis by Big Champagne (essentially the Nielsen or Arbitron ratings of the Internet)—and notwithstanding massively publicized litigation against individuals and companies—P2P usage last month reached nearly 9 million simultaneous users with access to over a *billion* song files. In August of 2003, a month prior to the first round of RIAA consumer lawsuits, there were 3.85 million P2P users.

By contrast, it has recently been estimated that the total number of songs now available for download through the iTunes and Rhapsody subscription services total fewer than 2.75 million tracks. Even if only a far-too-conservative one in five music files available through peer-to-peer software each day are taken to be unique songs, at least *60 times* more music files are available *each day* through P2P technology than are presently available to consumers through the two primary licensed channels.

More lawsuits are not going to change that reality. Writing the day before the Supreme Court’s ruling in *MGM v. Grokster*, Ms. Hillary Rosen, former head of the

RIAA, made a forceful case for new thinking and a new view of P2P software developers by her former colleagues in the music industry:

“It is said that the Supreme Court’s decision will be one of the most important copyright cases ever on the books. I think it has all the makings of being famous for another reason. Because while the victory of whoever wins maybe important psychologically, it just won’t really matter in the marketplace. . . .

“So why won’t this case matter now in the marketplace? Because by now SEVERAL HUNDRED MILLION copies of this software that the entertainment industry would like to vanquish have been downloaded to individual computers around the world. . . . And now, a majority of them are hosted outside the United States. There is no court ruling whose enforcement can keep up with this. Sure, it might affect some venture capitalist deciding where to put money for a product. But none of these services since Napster have required venture money. They grow organically, because they are serving a still unserved desire. Do people like free content, sure, but they also like content. All the stuff—when they want it—to feel like free even if it might not be free. . . . And the entertainment industry is still far too often spending time comparing the profit margins and risk of new ideas to an earlier time when the world was less digital. . . .

“So here is the crux of the problem. [P2P] services have traffic at a rate 40 to 50 times the traffic of legitimate sites. Yet, the amount of time and money wasted on besting the game by the entertainment and technology industries is huge. *This volume needs to be embraced and managed because it cannot be vanquished. And a tone must be set that allows future innovation to stimulate negotiation and not just confrontation* (emphasis added).”¹²

Ms. Rosen was equally emphatic in her appeal for a pragmatic view of the marketplace after the Court’s opinion was handed down the following day:

“. . . knowing we were right legally really still isn’t the same thing as being right in the real world. We had that euphoria with the first Napster decision. I hope my former colleagues remember that. The result was lots of back and forth and leverage hunting on both sides and continued litigation and then a great service shut down to make room for less great services. And more legal victories didn’t bring more market control no matter how many times it was hoped it would.

“The euphoria of this decision does not and should not change the need for the entertainment industry to push forward and embrace these new distribution systems. . . .¹³ For today, I hope all sides will take a deep breath and realize that this Supreme Court decision doesn’t change one bit their responsibility to move forward *together* on behalf of their consumer.”¹⁴

P2P United and EFF share Ms. Rosen’s clear (and clear-eyed) view that P2P technology will only become more available with time, that demand for its convenience and content will continue to increase, and that the current battles surrounding P2P file sharing thus are a losing proposition for all parties concerned, including consumers. We believe that the path forward lies in aligning the incentives of the entertainment industry with those of new Internet technologies in pursuit of a marketplace in which all musical artists and copyright holders are fairly compensated and such compensation is maximized because consumer demand in all its present and future forms is truly met.

With this goal and these realities in mind, P2P United and EFF urge the Committee to begin considering ways in which Congress might clear the path for solutions based on voluntary collective licensing.

(B) Voluntary Collective Licensing for Downloaded Music Merits Serious, Congressionally-Convened Discussion by All Relevant Stakeholders

What we propose is not unusual, unknown in the marketplace or conceptually complex. Indeed, the concept is familiar and simple.

First, the music industry (labels and music publishers) with representatives of artists and songwriters would form one or more voluntary collecting societies. These societies then would offer music consumers the opportunity to download music lawfully in exchange for a modest regular payment, perhaps \$5–\$10 per month.¹⁵

So long as they pay into the collective, consumers would be free to keep doing what they now do by the millions every day. . . . and are clearly going to do anyway: download and share the music they love using whatever software they like on whatever computer platform they prefer. Under this system, however, they would be able to do so without fear of litigation. Moreover, the money collected would be divided

among all rightsholders—whether signed to a major record label or not—based upon the professionally measured popularity of their music.

The more people who share, the more money will be available to rightsholders. The more competition in competing file-sharing products, the more rapid technological innovation and improvement will be. The more freedom for music aficionados to share what they care about, the deeper the available catalog to the benefit of all parties' in the system.

If this system of voluntary collective licensing seems familiar, that's because it has been in use to excellent effect for decades. In the face of a seemingly intractable impasse between a then-new technology and copyright owners, ASCAP, BMI and SESAC were brought into existence by songwriters to bring broadcast radio in from the copyright cold in the first half of the twentieth century. Songwriters originally viewed radio exactly the way the music industry today views P2P users—as “pirates.” After trying to sue radio out of existence, songwriters ultimately formed ASCAP (and later BMI and SESAC). Radio stations interested in broadcasting music stepped up, paid a fee, and in return got to play whatever music they liked, using whatever equipment worked best.

Today, the performing rights societies pay out hundreds of millions of dollars annually to their artists. Although these societies also have received some criticism, there can be no question that the system that has evolved for radio is preferable to one based on fruitlessly trying to sue radio into extinction one broadcaster at a time.

Beginning in this respected committee, P2P United and EFF believe that Congress can and should encourage detailed and serious evaluation of the potential of voluntary collective licensing in at least two important ways:

First, the Register of Copyrights, Marybeth Peters, recently proposed reforms to copyright law that would make it easier for existing collecting rights societies like ASCAP, BMI and SESAC to grant blanket licenses for digital downloads.¹⁶ We believe that her proposal is sound and, if adopted, would have the added benefit of establishing marketplace prerequisites for testing the full-range of collective licensing possibilities.

For example, as we read the Register's proposal, it would create “music rights organizations” legally empowered to grant blanket licenses directly to music consumers on behalf of songwriters. Because this proposal requires adjustments to both copyright and antitrust law within the purview of the Federal Trade Commission, it would appear to present a productive opportunity for inter-committee collaboration on these matters.

While adoption of the Register's proposal would be an important first step, it only addresses the music publishing side of the music industry. Any comprehensive solution must also involve major and independent record labels. Presently, no collecting society represents the major labels or can grant a blanket license directly to music consumers. Under current law, the highly concentrated nature of the industry, with just four companies controlling more than 90 percent of the market, such coordination presents antitrust challenges. Here, too, we see an opportunity for this committee to begin collaboratively exploring options that might remove this obstacle to an otherwise viable and desirable market-oriented licensing solution for the burgeoning digital music sector of the economy.

The advantages of such a collective licensing approach are potentially legion and mutually reinforcing:

- Artists and rightsholders will get paid for what are now literally *billions* of non-compensable music downloads not likely to cease or slow;
- Government intervention in the market will be minimal (limited to encouragement and oversight), and collecting societies will set their own prices in response to market forces;¹⁷
- Broadband deployment will get a real boost as the so-called “killer app”—music file sharing—is legitimized and actively encouraged;¹⁸
- Investment dollars will pour into the newly legitimized market for digital music file-sharing software and services, prompting an explosion of different service offerings and devices;¹⁹
- Music fans finally will have completely legal access to the essentially unlimited selection of music that only a network built from the collections of other fans can provide. With the threat of litigation and defensive file “spoofing” eliminated, these networks will rapidly improve and grow, affording millions more consumers access to rare recordings long unavailable in the marketplace;
- The distribution bottleneck that has limited the opportunities of independent artists and placed them at the economic mercy of the major record labels for

decades will be eliminated. Artists will be able to choose any road to online popularity—including, but no longer limited to, a major label contract. So long as their songs are being shared among fans, they will be paid;²⁰ and

- Payment will come only from those who are interested in downloading music, and only so long as they are interested in downloading.

Conclusion

As sensible as we hope the idea of voluntary collective licensing now seems, the RIAA and the major corporations that it represents have dismissed the idea and have refused to engage in any discussion of the subject with appropriate stakeholders. Accordingly, we respectfully request that this committee either hold hearings on this issue, or—at minimum—formally invite all relevant parties (public and private sector alike) to a series of roundtable discussions of collective licensing’s potential to unleash the true market power and potential of peer-to-peer technology and, with it, the genius of American technological innovation.

P2P United and the Electronic Frontier Foundation thank you again for the opportunity to participate in these proceedings, Mr. Chairman. As proposed, we hope for similar opportunities in the near future.

ENDNOTES

¹ J. Mitchell, “Free Man in Paris” released on “Court & Spark” (© 1973; Crazy Crow Music).

² Each theory of liability is independent of the other and requires proof of two elements. Contributory infringement may arise when a defendant knows about infringing activity *and* materially contributes to it, while vicarious liability requires proof that a defendant profits directly from the infringement *and* has a right and ability to supervise the direct infringer.

³ EFF and P2P United believe that the attached Consumer Electronics Association “one-pager” on the *MGM v. Grokster* decision (recently solicited by the Congressional Internet Caucus Advisory Committee) states these concerns very well. We here submit it for the record and wish to underscore CEA’s conclusion that: “This new legal ambiguity [as to what constitutes culpable inducement] will not enhance America’s competitiveness. Foreign firms will continue to receive funding and ship products free from concern about overreaching IP litigation, while their American counterparts will need to demonstrate compliance with Grokster’s ambiguous legal test.”

We also concur with the recently reported remarks of Mr. James Burger, outside counsel to Intel, who warned against the potential that the discovery-intensive litigation required by the Court’s new inducement standard could give rise to a form of “greenmail” directed at small companies by large plaintiffs who might demand significant settlement fees in exchange for dropping baseless, but potentially ruinous, litigation. N. Graham & A. Mazumdar, “Parsing *Grokster* . . .,” *BNA Patent, Trademark & Copyright Journal*, Vol. 7 No. 1728 at 327 (July 15, 2005).

⁴ Concerning contributory liability standards, Justice Breyer, joined by Justices O’Connor and Stevens, adopted and endorsed the views expressed by EFF and many of the other technology sector *amici*, declaring that “Sony’s rule is strongly technology protecting Sony thereby recognizes that the copyright laws are not intended to discourage or to control the emergence of new technologies, including (perhaps especially) those that help disseminate information and ideas more broadly or more efficiently.” *MGM v. Grokster*, 125 S. Ct. at 2791. Justice Ginsburg, joined by Chief Justice Rehnquist and Justice Kennedy, rejected the bright-line interpretation. Unmoved by the argument that *Sony* bars a finding of contributory infringement unless a technology is almost exclusively used for infringement, Justice Ginsburg declared, “Sony, as I read it, contains no clear, near-exclusivity test.” *Id* at 2784 n.1.

⁵ Having disposed of the case on inducement grounds, the Court did not reach the vicarious liability theories briefed by the parties, merely restating that the doctrine “allows imposition of liability when the defendant profits directly from the infringement and has a right and ability to supervise the direct infringer.” *MGM v. Grokster*, 125 S. Ct. at 2776 & n.9. By contrast, the lower courts in *MGM v. Grokster* responded in some detail to the diametrically opposing views of the parties regarding vicarious liability. The entertainment industry had argued that the ability to redesign a product to reduce infringing uses ought to be deemed equivalent to a “right and ability to supervise” the customers who use the technology. The P2P defendants replied that such a “could have designed it differently” test would effectively force technology companies to redesign their products to suit the demands of copyright owners. On this point, the Solicitor General’s amicus brief before the Supreme Court sided with the defendant/respondents: “The ‘right and ability to super-

wise' element of vicarious liability . . . has never, to our knowledge, been held to be satisfied by the mere fact that the defendant could restructure its relations or its product to obtain such an ability." Brief for the United States as Amicus Curiae Supporting Petitioners at 20 n.3, available at: www.eff.org/IP/P2P/MGM_v_Grokster/050124_US_Amicus_Br_04-480.pdf.

⁶When two motion picture studios sued Sony in 1976 for selling the first Betamax VCR, they did so under a contributory liability theory. In that case, *Sony v. Universal City Studios*, 464 U.S. 417 (1984), the Supreme Court announced the "Betamax doctrine," holding that a technology vendor could not be held liable for distributing a technology "capable of substantial noninfringing uses." Because the Betamax VCR was plainly capable of noninfringing uses, the Supreme Court did not hold Sony liable. Since the Court's *Sony* ruling, the technology and entertainment industries characterized the scope of the "Betamax defense" very differently. Technologists saw a bright-line rule: so long as a technology is merely capable of non-infringing uses in commerce, it is legal to distribute, regardless of how some (or even most) customers might actually use it. Hollywood movie studios and the music industry, in contrast, read the case much more narrowly, reasoning that Sony was only excused from liability because a principal use of the Betamax device (as they have interpreted the decision) was noninfringing.

⁷See extended interview with Mr. Jamie Kellner entitled "Content's King," *Cableworld* (April 29, 2002) ["JK: It's theft. Your contract with the network when you get the show is you're going to watch the spots. Otherwise you couldn't get the show on an ad-supported basis. Any time you skip a commercial or [press] the [30-second advance] button you're actually stealing the programming." The full text of this sobering interview is available online at: www.2600.com/news/050102-files/jamie-kellner.txt.

⁸The "crime" Slingbox's developers may have committed is permitting a consumer who has paid for programming at home to "sling" that same programming to a single remote location or portable device so that it may be enjoyed while the consumer is away from home. See A. Wallenstein, "Slingbox Could Spark New Lawsuit," *Hollywood Reporter* (July 6, 2005), also at: www.hollywoodreporter.com/thr/article_display.jsp?vnu_content_id=1000973572.

⁹See generally Apple's online archive of such data at www.apple.com/pr/library.

¹⁰As of early last month, the RIAA reportedly had brought 11,456 lawsuits and collected an average of \$3,600 from each of almost 2,500 defendants. See S. Knopper, "RIAA Will Keep On Suing," *Rolling Stone* (June 9, 2005) at: www.rollingstone.com/news/story/_/id/7380412/?pageid=rs.Home&pageregion=single1&rnid=1122320285908&has-player=true&version=6.0.12.872.

¹¹See S. Knopper, "RIAA Will Keep On Suing," *Rolling Stone* (June 9, 2005), cited above at n.10.

¹²See H. Rosen, "The Supreme Wisdom of Not Relying on the Court," *The Huffington Post* (June 26, 2005) at: www.huffingtonpost.com/theblog/archive/hilary-rosen/the-supreme-wisdom-of-not-3221.html.

¹³The absence in the current market of P2P software providers licensed to promote the labels' own online music downloading services, or to make licensed music available directly to the public, is not due to a lack of effort by P2P developers to obtain such contracts. As early as 2001, the original Napster pleaded with the major labels for such a license, reportedly offering a billion dollars in royalties. More recently, as Chairman Smith's Competition Subcommittee heard in direct testimony in June of last year, P2P United member Streamcast (the makers of the Morpheus software also at issue in the Supreme Court's opinion) was poised to finalize a contract with RealNetworks to promote the major labels' own "Rhapsody" subscription service to millions of Morpheus' P2P software users. With only a signature between Streamcast and such a license, the Streamcast business development executive who sought the deal was told *twice* in a voice mail recording previously provided to the Commerce Committee that Streamcast had been "blacklisted" by "the labels" and that RealNetworks thus could not consummate the otherwise fully negotiated deal. A transcript of that voice mail recording is again submitted for the record and the full Committee's consideration.

¹⁴See H. Rosen, "The Wisdom of the Court, Part II," *The Huffington Post* (June 27, 2005) online at: www.huffingtonpost.com/theblog/archive/hilary-rosen/the-wisdom-of-the-court-3259.html.

¹⁵This hypothetical price is based upon Yahoo's Y! Music Unlimited, which offers consumers unlimited access to more than 1 million songs for as little as \$4.99 per month. See <http://music.yahoo.com/unlimited/>.

¹⁶Statement of Marybeth Peters, Register of Copyrights, hearing on "Music Licensing Reform" before the Subcommittee on Courts, the Internet, and Intellectual

Property, Committee on the Judiciary, U.S. House of Representatives, 109th Congress, 1st Session, June 21, 2005. See www.copyright.gov/docs/regstat062105.html.

¹⁷The \$5 per month figure noted above is a suggestion, not a proposed mandate. Because collecting societies will make more money with a palatable price and a larger base of subscribers than with a higher price and expensive enforcement efforts, the market may be relied upon to keep consumer pricing reasonable.

¹⁸Moreover, such a system will further drive demand for broadband communications services and, with greater broadband delivery of musical content, the more revenue major corporate copyright industries will get paid. Under such circumstances, the entertainment industries' powerful lobby may be expected to begin affirmatively working for an expansive and innovation-driven Internet, instead of against it.

¹⁹Rather than being limited to a handful of "authorized services" like Apple's iTunes and Napster 2.0, the market is likely to give rise to competing file-sharing applications and ancillary services. Moreover, so long as individual consumers are licensed, technology companies need not worry about negotiating the nearly impossible maze of current music licensing requirements and may focus instead on providing the public with the most attractive products and services in a competitive marketplace.

²⁰Indeed, the ability of independent artists to negotiate as they may choose with one or more record labels will only be enhanced by their ability to document and quantify their revenue-generating potential and overall popularity with certified download royalty data. For the first time in history, under a voluntary collective licensing regime, independent artists may well be able to truly bargain at arm's length with major music industry conglomerates.

IMPACT OF THE SUPREME COURT GROKSTER DECISION BY THE CONSUMER ELECTRONICS ASSOCIATION

About CEA: The Consumer Electronics Association (CEA) is the preeminent trade association promoting growth in the consumer technology industry through technology policy, events, research, promotion and the fostering of business and strategic relationships. 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 Position: We are pleased that the Supreme Court preserved the core principle of the "*Betamax*" decision, where as the mere distribution of a product that has substantial non-infringing uses does not expose a distributor to contributory infringement. In other words, the Court said that infringing business models, rather than the technology itself, should determine liability.

However, we are concerned with the Court's establishment of an inducement standard and how it will be interpreted by the lower courts. The ambiguity created by this standard will generate an uncertain legal environment for innovators and investors, since the Court provided minimal guidance as to what acts qualify as "bad behavior."

For example, does the marketing phrase "Rip, Mix, Burn" qualify as inducement to infringe? What if you are developing a product with knowledge that you could make your technology more "infringement proof" merely by tripling the cost of development? If you don't do so, are you inducing?

We expect that corporate counsels and investors will now err on the side of caution when deciding whether to introduce innovative new products and services. This is especially true now that litigation will go to the issue of intent, making it very difficult to have an infringement suit dismissed quickly on summary judgment. Instead, entrepreneurs will face expansive discovery rules examining the notes of engineering meetings, marketing plans and e-mails of executives.

This new legal ambiguity will not enhance America's competitiveness. Foreign firms will continue to receive funding and ship products free from concern about overreaching IP litigation, while their American counterparts will need to demonstrate compliance with Grokster's ambiguous legal test.

We will not realize the overall impact of this decision until it is tested in the lower courts. We hope that the 9th Circuit interprets this decision narrowly, implicating only the specific marketing statements at issue in this case.

CEA will continue to work for a pro innovation environment, while cooperating with the content industry on developing legitimate business models.

TRANSCRIPT OF VOICEMAIL MESSAGE FORWARDED TO MICHAEL WEISS, CEO OF STREAMCAST BY STREAMCAST VICE PRESIDENT OF BUSINESS DEVELOPMENT, ELIZABETH COWLEY LEFT BY REAL NETWORKS' GENERAL MANAGER OF CONSUMER PRODUCTS, RYC BROWNRIGG (SEPTEMBER 8, 2003)

"Hey, Elizabeth. It's Ryc [Rick] Brownrigg. Rhapsody and Listen are one in the same. Rhapsody is the service that's offered by the Listen team, which is now our San Francisco team.

Unfortunately, the licenses for the ability to stream to Rhapsody come from the labels, as you are aware. And the labels have blacklisted you guys. So that is the problem we've got. Basically, what they're saying is you've got to denounce P2P and/or resolve the lawsuit—is what you have to do.

And so, until they resolve the lawsuit they're going to keep you on the blacklist, which means I'm probably not going to get much latitude to do anything as far as Rhapsody goes. So, I mean, I'm still willing to give you the client and work with you on the client, but unfortunately, I'm not going to be able to do anything as far as helping you with the service in any short order.

So if you want to give me a call [NUMBER OMITTED], we can chat about it more, but I don't know if this is still of interest to you to work with us being as you have this limitation. Talk to you later. Bye."

The CHAIRMAN. Thank you very much.

Our next witness is Gregory Kerber, Chairman and CEO of Wurld Media, Incorporated, which is the creator of a peer-to-peer platform currently in its test phase and has signed partnerships with Sony, BMG, Music Entertainment, Universal Music Group, Warner Music Group, and EMI.

We're interested in your comments, Mr. Kerber.

**STATEMENT OF GREGORY G. KERBER, CHAIRMAN AND CEO,
WORLD MEDIA, INC.**

Mr. KERBER. On behalf of Wurld Media, I'd like to thank the Chairman and Co-Chairman and every member of the Committee of Commerce, Science, and Transportation for conducting this hearing and the effects of the U.S. Supreme Court decision in *MGM v. Grokster*, as delivered by the Justice Souter on June 27, 2005.

My name is Greg Kerber. I'm Chairman and CEO of Wurld Media, an advanced technology company located in Saratoga Springs, New York, and that's Upstate New York.

Wurld began in 1999 as a small technology company and was funded and capitalized by family, friends, and founders who believed in the future of the industry and believed in the future of this new economy, called "digital media." Wurld has developed a platform for the secure sale and scalable distribution of copyrighted protected digital media. The company's platform is called Peer Impact, which he will be launching to the public on August 5th, next week—features an architecture and enables music copyright holders, computer gaming companies, video producers, movie studios, book publishers, and other digital media owners to securely propagate their content across a peer impact network for legitimate sale to, and download from, any Peer Impact-connected computer on our network.

The advancement in peer-to-peer technology creates an endless capability to provide every kind of digital media to consumers in a safe environment free from viruses, unauthorized content, child pornography, spyware, and identity gatherers, while at the same time providing the ability to have parental controls and ensuring that all the rights-holders in the value chain receive payment for their creative works. This is just the tip of the iceberg, as far as

we are concerned. These advanced technologies are now beginning to enable the virtualization and creation of the supply chain through new and emerging businesses.

This hearing is important, because it is exploring the effects of the decision in the Grokster case. Without going into any kind of legal analysis of the case, because I'm not an attorney, I can say that, as a business person running a legitimate peer-to-peer business, this decision clearly illustrates that our system of government is working to achieve the correct balance between protecting the consumer, the creators of intellectual property, and that of advancing technology.

Prior to the decision, the primary motivating elements in any evolution of peer-to-peer technology was the avoidance of culpability, not for the sake of innovation or enhancing the consumer experience. It was acceptable and lawful to allow illegal activity to exist and to thrive within a network if the system was simply designed to appear uncontrollable, something we called the Frankenstein Monster Scheme.

One of the many negative outcomes of this lawlessness is the rampant content of child pornography that proliferates on illegal peer-to-peer networks. The United States General Accounting Office, in conjunction with many others, the Customs Cyber-Smuggling Center detailed study of peer-to-peer networks and discovered that when using innocuous searches, with search terms routinely used by children, 56 percent of the results returned were pornographic in nature. This decision now forces these bad actors to be accountable. There are no longer—they can no longer ignore laws that have been put in place to protect the economy, the development of intellectual property, and, most importantly, the future: our children.

This decision allows companies like ours to be able to grow and prosper and compete fairly in the marketplace based upon meeting consumers' needs, providing a safe environment and not having to compete with business models that are based upon stealing content.

The benefits from this decision include what—that we will be able to provide employment opportunities to citizens of Upstate New York, Southern California, and right here in Washington, D.C., as we rapidly expand our staffing to keep up with new content partners and to continue the evolution of our network.

Innovation is not gone, but, rather, it's just beginning. In addition to providing jobs for U.S. citizens, we will be able to contribute to the Nation's gross national product, pay taxes, and, as we launch our services in other areas of the globe, contribute to the reversal of the balance of payments.

The benefits from this decision include that of the consumer. The consumer wins as we will be able to provide a product to consumers that creates convenience, choice, and family safety.

Our peer-to-peer partnership include not only the copyright-holder and the creator of the original works, but the consumer, as well, who can now be involved in the economic distribution of digital media. The consumer will find a limitless choice in a world connected by a network that contains all the content they want, but not having to be concerned about their personal information at

risk, that their children are going to be viewing inappropriate material, or that they're downloading viruses or Trojan horses that will, at some point in the future, take over their operating system, or that they are doing something online that they would never dream of doing at a store, which is stealing works that others have created, without paying for them.

The benefits from this decision include that venture capital can once again feel safe in investing in advanced technologies in legitimate peer-to-peer services without the fear of impending litigation. Anecdotally, I should note that the interest in our company from top-tier venture capital community immediately following this decision has been pretty overwhelming. The decision finally provides firm basis upon which the pirates and bad actors can be distinguished from the legitimate businesses, permitting capital flow once again into those advanced Technology companies that we can be proud of on the world stage; businesses that will provide employment for U.S. citizens instead of those businesses that hide themselves in the dark corners of other countries to avoid the laws of the U.S.; companies that will now be able to convert their nascent industry into one that the country can be proud of and can exist without relying on illegal, immoral activities.

The benefits from this decision include that legitimate industry can solidly emerge and prosper. The industry is an advanced technology industry that respects the intellectual property of the content creator by properly remunerating those who make contributions throughout the value chain. It's unlimited and global in nature, and now provides a level playing field in which innovation can flourish and a business can compete fairly.

Let me summarize by saying this. The decision will positively affect the future development of advanced technology for media distribution and the associated hardware and software industries. This decision puts to rest that they serve to hold the consumer-friendly new advances in stasis. Venture capital can now invest in legitimate businesses, knowing with certainty they will be able to compete fairly on the quality of their offerings.

We look forward to continuing to provide a safe place for intellectual property, so that the creation of original works can be inspired and retain its valued place in our society.

Thank you.

[The prepared statement of Mr. Kerber follows:]

PREPARED STATEMENT OF GREGORY G. KERBER, CHAIRMAN AND CEO,
WORLD MEDIA, INC.

On behalf of Wurld Media, Inc., I thank Chairman Stevens and Co-Chairman Inouye—and every Member of the Committee on Commerce, Science, and Transportation—for conducting this hearing on the effects of the U.S. Supreme Court decision in *MGM v. Grokster* as delivered by Justice Souter on June 27, 2005.

I am Greg Kerber, Chairman and CEO of Wurld Media, an advanced technology company located in Saratoga Springs, New York. Wurld began in 1999 as a small technology company, capitalized by family and friends, who believe in the future of this industry. Wurld Media has developed a platform for the secure sale and scalable distribution of copyright-protected digital media. The company's platform, Peer Impact™, features an architecture that enables music copyright holders, computer gaming companies, audio book publishers and other digital media owners to securely propagate their content across the Peer Impact network for legitimate sale to, and download from, any Peer Impact connected computer. This advancement in peer-to-peer technology creates endless capabilities to provide every kind of digital

media to consumers, in a safe environment, free from: viruses, unauthorized content, child pornography, spyware, and identity gatherers, while at the same time providing the ability to have parental controls and ensuring that all rightsholders in the value chain receive payment for their creative works. This is just the tip of the iceberg as far as we are concerned. These advanced technologies are now beginning to enable the virtualization of the supply chain through new and emerging businesses.

This hearing is important because it is exploring the effects of the decision in the *Grokster* case. Without going into any kind of legal analysis of the case, as I am not a lawyer, I can say that as a businessman, running a legitimate peer-to-peer business, this decision clearly illustrates that our system of government is working to achieve the correct balance between protecting the creators of intellectual property and that of advanced technology. Prior to this decision, the primary motivating elements in any evolution of peer-to-peer technology was the avoidance of culpability, not for the sake of innovation or enhancing consumer experience. It was acceptable and lawful to allow illegal activity to exist and to thrive within a network if the system was simply designed to appear to be uncontrollable. One of the many negative outcomes of this lawlessness is the rampant child pornography that proliferates on the illegal peer-to-peer networks. The United States General Accounting Office, in conjunction with, among others, the Customs CyberSmuggling Center, conducted a detailed study of peer-to-peer networks and discovered that when using innocuous searches, with search terms routinely used by children, 56 percent of the results returned were pornographic in nature.¹ This decision now forces these bad actors to be accountable. They can no longer ignore laws that have been put into place to protect the economy, the development of intellectual property, and, most importantly, our children. This decision allows companies like ours to be able to grow and prosper and compete fairly in the marketplace based upon meeting consumer needs, providing a safe environment and not having to compete with business models that are based upon stealing content.

The benefits from this decision include that we will be able to provide employment opportunities for the citizens of upstate New York and beyond as we rapidly expand our staffing to keep up with new content partners and to continue the evolution of our network. Innovation is not gone, but rather, just beginning. In addition to providing jobs for U.S. citizens, we will be able to contribute to this Nation's gross national product, pay taxes, and as we launch our services in other areas of the globe, contribute to the reversal of the balance of payments.

The benefits from this decision include that the consumer wins as we will be able to provide a product to consumers that creates convenience, choice and family safety. Our peer-to-peer partnerships include not only the copyright holder and the creator of original works, but the consumer as well, who can now be involved in the economics of distribution. The consumer will find a limitless choice in a world connected by a network that contains all the content they want but not having to be concerned that their personal information is at risk, that their children are going to be viewing inappropriate material or that they are downloading viruses or Trojan horses that will, at some time in the future, take over their operating system, or that they are doing something online that they would never dream of doing in a store; stealing works that others have created without paying for them.

The benefits from this decision include that venture capital can once again feel safe in investing in advanced technologies, in legitimate peer-to-peer services, without the fear of impending litigation. Anecdotally, I should note that the interest in our company from the venture capital community immediately following the decision has been overwhelming. This decision finally provides a firm basis upon which the pirates and bad actors can be distinguished from legitimate businesses, permitting capital to flow once again into those advanced technology companies that we can be proud of on the world stage; businesses that will provide employment of U.S. citizens instead of those businesses hiding themselves in the dark corners of other countries to avoid the laws of the U.S.; companies that will now be able to convert this nascent industry into one that this country can be proud of and that can exist without relying on illegal and immoral activities.

The benefits from this decision include that a legitimate industry can solidly emerge and prosper. That industry is an advanced technology industry that respects the intellectual property of content creators by properly remunerating those who make contributions throughout the value chain, is unlimited and global in nature, and now provides a level playing field upon which innovation can flourish and businesses can compete fairly.

¹“File-Sharing Programs, Peer-to-Peer Networks Provide Ready Access to Child Pornography,” United States General Accounting Office, February 2003.

Let me summarize by saying that this decision will positively affect the future development of advanced technology for media distribution and the associated hardware and software industries. This decision puts to rest questions that had served to hold many consumer-friendly new advances in stasis. Venture capital can now invest in legitimate businesses, knowing with certainty that they will be able to compete fairly and on the quality of their offerings. We look forward to continuing to provide a safe place for intellectual property so that the creation of original works can be inspired and retain its valued place in our society.

The CHAIRMAN. Thank you very much.

Our next witness is Mark Heesen, President of the National Venture Capital Association, representing 450 venture capital and private equity firms, accounting for more than 85 percent of U.S. venture funding.

Mr. Heesen?

**STATEMENT OF MARK G. HEESEN, PRESIDENT,
NATIONAL VENTURE CAPITAL ASSOCIATION**

Mr. HEESEN. Thank you very much, Mr. Chairman.

The venture-capital sector has grown, since its inception just 50 years ago, to become a major force in the U.S. economy. In fact, in 2003, venture-capital-funded companies were directly responsible for 9.4 percent of all U.S. private-sector employment, as well as 9.6 percent of all companies' sales in the United States.

To be able to make this type of impact on the U.S. economy, as well as on the lives of every American, VCs invest with a particular emphasis on emerging companies in the information technology, communications, and life-science industries. These areas, in particular, have been where we have found that destructive technologies, those which upset the status quo, but in the long run produce exponential societal, financial, and technological advances, reside.

Disruptive technologies, by their very nature, often put on notice entrenched older interests that their primacy in a particular area is at risk. If they wish to continue to succeed, they have a decision to make, whether they move forward in helping to usher in the new model or to stay wedded to a business model no longer accepted in the marketplace.

Such a dynamic makes the venture-capital community the financial lynchpin to technology and medical advances, and, thus, a hero to many, while simultaneously making us a black hat as the destructors of the status quo on the other. The *MGM v. Grokster* decision is emblematic of this.

Prior to the Supreme Court's decision in *Grokster*, the venture community was deeply concerned that any erosion of the bright-line protection provided in *Sony v. Universal* for disruptive products that are capable of substantial non-infringing uses would have a chilling effect on innovation and product design by developers of multi-use technologies and services. We believe that the Supreme Court's decision in *Grokster* is favorable to the venture-capital industry, insofar as the court rejected the studio's strong efforts to cut back on the protections for innovative technologies that have the potential for substantial non-infringing uses.

With the Sony bright-line rule intact, hopefully only those players who willfully promote copyright infringement will be subject to,

and should be subject to, potential liability for secondary infringement of copyrights.

Unfortunately, the entertainment industry has never been satisfied with attacking direct instances of infringement. For more than a century, the industry has attacked, in turn, each new development, each destructive technology that facilitates copying and distribution, from phonographs to mimeographs, from audiotape players to VCRs, from compact discs to mp3 players. As each new technology has developed the industry has sought to destroy or control it, sometimes extending their attacks to the inventors who created, and *the investors who funded, that product or service.*

The *Grokster* decision reaffirmed the principle that new products and services will be protected, provided they are capable of substantial non-infringing uses. Entrepreneurs and their investors should be able to move forward in developing novel products without constant concern that some unforeseen future use could impose ruinous liability.

Venture capitalists believe in the power of the market. The market, rather than the Federal courts, should drive investment decisions. Unfortunately for everyone involved, the Supreme Court left many liability questions outside of the Sony bright-line protection unanswered in *Grokster*. For venture capital firms, this additional legal uncertainty will continue to make us less inclined to invest in this critical information technology at a time when the rest of the world is quickly catching up to our expertise in this area.

As lower Federal courts begin to study and apply the *Grokster* decision, NVCA believes that we all have an opportunity here for some breathing space, one in which technologies can continue to emerge. There should be no rush to judgment from any sector, be it from the entertainment or technology communities or investors or Congress. However, if the entertainment industry decides to initiate even greater volumes of litigation against inventors, investors, and their destructive technologies, Congress may need to return its focus to this issue.

Thank you very much.

[The prepared statement of Mr. Heesen follows:]

PREPARED STATEMENT OF MARK G. HEESSEN, PRESIDENT,
NATIONAL VENTURE CAPITAL ASSOCIATION

Thank you for the opportunity to share the views of the National Venture Capital Association (NVCA). NVCA represents the interests of more than 470 venture capital firms in the United States, which together account for more than 85 percent of venture funding. As the only national trade group for the venture community, the NVCA's mission is to foster public awareness of the vital role that venture funding plays in driving the United States economy and to advocate public policies that stimulate entrepreneurship and innovation.

While the importance of venture capital firms and the companies they fund to the United States economy is difficult to quantify, recent studies estimate that, in 2003, venture-backed businesses were responsible for more than 10.1 million American jobs and accounted for more than \$1.8 trillion of the United States Gross Domestic Product (GDP).¹ Such economic mainstays as Intel, Federal Express, Home Depot, Genentech, Google, and Starbucks were incubated with venture funding. Each year, venture firms invest more than \$18 billion in start-up companies across the country, which accounts for an estimated 72 percent of all venture investment worldwide. A

¹See Global Insight, *Venture Impact 2004: Venture Capital Benefits to the U.S. Economy 1* (2004).

decidedly American phenomenon, venture capital funds and the companies they back provide a key differentiator animating American economic growth.

The NVCA's members invest with a particular emphasis on emerging companies in the information technology, communications, and life sciences industries. In addition to providing early funding to young businesses unable to secure capital from more traditional sources, NVCA's member firms take an active role in guiding nascent businesses through their start-up and middle phases. They work with the entrepreneurs and management, lending their experience and expertise while developing long-term partnerships.

NVCA's member firms accordingly have a unique perspective on the hurdles that emerging businesses confront and the background conditions that promote or stifle growth and innovation. Prior to the Supreme Court's decision in *MGM v. Grokster*, NVCA's member firms were deeply concerned that any erosion of the bright-line protection provided in *Sony Corporation of America v. Universal City Studios, Inc.* for products that are "capable of substantial noninfringing uses" would have a chilling effect on innovation and product design by developers of multiple-use technologies and services.

We believe that the Supreme Court's decision is favorable to the venture capital industry in so far as the Supreme Court rejected the studios' strong efforts to cut back on the protections for innovative technologies that have the potential for substantial non-infringing uses. With this bright-line rule intact, hopefully only those players who willfully promote copyright infringement will be subject to—and should be subject to—potential liability for secondary infringement of copyrights. A company or a venture capital firm that brings to market technologies that have the potential for legitimate, non-infringing uses, and that markets the technologies based on those non-infringing uses, should remain protected from secondary liability, even though other third parties might discover ways with the technologies to infringe on copyrights.

NVCA's members are pleased that a new standard for contributory infringement as proposed by the petitioners in *Grokster* was not created. Such a standard would have been virtually impossible for venture capital firms to accommodate in making their initial investment decisions, when the potential commercial applications of a promising concept are still far in the future. Having said this, NVCA is concerned that *Grokster's* long-term impact could still be very problematic for technology advancement in general and the VC community specifically. Such malleable standards—vague in their formulation and unpredictable in their application—could invite courts to second-guess design decisions and expose venture firms to potentially ruinous litigation.

Attacking Innovation

Any technology or service that makes it possible to copy or distribute information can be used for copyright infringement. The list of such technologies—which today includes computers, the Internet, and e-mail, as well as CD burners, iPods, and peer-to-peer file sharing—is extensive, as is the range of their legitimate uses. Modern life would be impossible to envision without such "dual use" technologies. Indeed, these "technologies of freedom"—which allow the rapid spread of information free of decentralized control—are critical to our modern democracy, as well as to our productivity and economic well-being.

Freedom, however, is sometimes abused. There are, and always have been, those who would abuse the power afforded them by new technologies to copy and distribute works that belong to others. Existing copyright laws provide severe penalties for such direct infringement, recognizing that the few who are caught must provide an example and deterrent for others.

But the entertainment industry has never been satisfied with attacking *direct* instances of infringement. For more than a century, when it first claimed that the player piano spelled the death of American music, the industry has attacked in turn each new development that facilitates copying and distribution, from phonographs to mimeographs, from audiotape players to VCRs, from compact disks to mp3 players. As each new technology has developed, the industry has sought to destroy or control it, often extending their attacks to the inventors who created and the investors who funded the product or service.

Fortunately, these attacks have been largely unsuccessful. (And their failure, ironically, has been good for the entertainment industry itself, which has in the long run benefited hugely from the new methods of distribution.) Under the bright-line rule established by the Court in *Sony*, technologies and services that are "capable of substantial noninfringing uses" are protected from secondary copyright liability, regardless of whether (or how many) others use those technologies and services for direct infringement of copyrights. Responsibility for copyright infringement rests

where it belongs: on the shoulders of those who abuse products to infringe copyrights, not on those who create or invest in products capable of substantial non-infringing uses.

This bright-line protection has been critical to technological progress. Entrepreneurs have been able to develop novel products without worrying that illegitimate uses could impose ruinous liability. Because markets take time to develop, and because the future uses to which a product may one day be put (both legitimate and illegitimate) are not necessarily evident in its early phases, *Sony* allows an innovation to incubate without fear that third-party infringement (present or future) will invite litigation.

***Sony* Bright-Line Rule Critical To Capital Investment**

“[E]very invention is born into an uncongenial society, has few friends and many enemies.”² In *Sony*, the Supreme Court fashioned a margin of protection for such nascent technologies. The Court articulated a bright-line rule for determining liability under the doctrine of contributory infringement that armed inventors and product developers—and those who fund them—with the knowledge that a technology or service with legitimate uses would not be driven out of the market because some or even most customers may use the product to infringe copyrights.

The Court’s bright-line rule in *Sony* has been the midwife for the technological revolution of the past two decades. It is not by chance that the *Sony* decision coincided with a period of unprecedented innovation and technological progress. By establishing a bright-line rule that protects new products and services—and the investors—provided they are “capable of substantial noninfringing uses,” *Sony* has provided critical assurance to entrepreneurs that they could develop novel ideas and products without worrying that some unforeseen future use could impose ruinous liability.

Entrepreneurs frequently invent new products without any clear picture of their potential uses, secure in the belief that a good idea will eventually find a market. That others could use the invention for copyright infringement is and should be irrelevant to the question whether the product or process can be placed in service of alternative, legitimate ends. One cannot even begin to count the staples of modern life—radios, typewriters, tape recorders, cameras, photocopiers, computers, fax machines, cassette players, cell phones, CD burners, DVD players, e-mail, cable modems and DSL for high-speed Internet access, Internet search engines such as Google and Yahoo, TiVos, and mp3 players such as the iPod—that can be used to infringe copyrights and yet have perfectly legitimate uses that we increasingly could not do without. Peer-to-peer networks are another such innovation, whether used to share photos among family and friends, to promote the music of a new band, or to share research among scholars.

The *Sony* case itself provides the best illustration of the fact that products often arrive before their primary markets emerge. At the time that case was decided, the Betamax was used primarily for copying shows from over-the-air broadcasts, either to build a library of such shows or simply to engage in time-shifting.³ The primary dispute between the majority and the dissent concerned whether time-shifting was itself a fair use of the copyrighted material.⁴ But the Betamax and its ultimately more successful competitor, the VHS VCR, quickly evolved into something quite different: a means of viewing lawfully rented movies. A whole industry grew up to provide legitimate materials for a product that the entertainment industry sought to crush in its infancy. That was possible only because the Court in *Sony* provided a protected space in which these legitimate uses could grow. In that case, as in many others, the product created its own legitimate market.

The entertainment industry in its Supreme Court brief on *Grokster* suggested that the *Sony* test encourages bad behavior by inventors and product designers who hide behind its protections in order to make money off infringement.⁵ That is certainly possible but, as we argued in our Amicus Curiae brief, that it is not a reason to change the *Sony* bright-line test established by the Supreme Court. The Justices agreed with our line of thinking in *Grokster*. As long as a product is capable of substantial, non-infringing uses, it is a socially useful product, whose development should be encouraged. *Abuse of the product should be attacked, not the product itself, nor the inventor behind it, nor the venture capitalist who funded the venture.* If a

² Joel Mokyr, *The Lever of Riches: Technological Creativity and Economic Progress* 183 (1990) (internal quotation marks omitted).

³ See 464 U.S. at 423 (surveys by both respondents and Sony “showed that the primary use of the machine for most owners was ‘time-shifting,’” although surveys also showed “that a substantial number of interviewees had accumulated libraries of tapes”).

⁴ *Id.* At 442, 447–56; *id.* At 477–86 (Blackmun, J., dissenting).

⁵ See Motion Picture Studio Pet. Br. 9–11, 27–29; U.S. Br. 17; Am. Tax Reform Br. 13–15.

company materially assists or encourages specific acts of infringement—whether through customer support mechanisms or other communications—secondary liability might well be appropriate.⁶ But the mere acts of developing, advertising, marketing, upgrading, and supporting a multi-use product that is capable of substantial non-infringing uses should be protected, without necessitating a fact-specific, inherently amorphous inquiry into the motivations and incentives of the inventor.⁷

It is critical to understand that the threat of secondary liability from copyright suits is qualitatively different from most other sorts of business risk that investors can insure against or build into their risk calculations. The mandatory mechanism of statutory damages—designed to discourage *direct* infringement—has crushing implications for vendors of multi-purpose technologies, where damages from unforeseen users can quickly mount in the millions and even billions of dollars. And the indeterminate reach of such secondary liability means that not merely start-up capital is at risk, but also the personal wealth of start-up's officers, directors, and investors.⁸ The litigation risk in such circumstances is wholly one-sided: minimal attorneys' fees for the plaintiffs versus financial annihilation for the defendants. It would be impossible to create a more chilling environment for creativity and product development.⁹

Standards Proposed By Entertainment Industry Would Deter Investment And Innovation

In their *Grokster* briefs before the Supreme Court, both the petitioners and the United States asked the Court to replace *Sony's* clear rule of law with malleable legal standards that would trade certainty for legal risk. Moving from the bright-line *Sony* rule to any sort of malleable standard—with its attendant loss of certainty—would undermine investment in innovative technology.

The evolution of the business model for the VCR at issue in *Sony* demonstrates the danger of predicting a future pattern of use. While the studios predicted on the basis of early experience that the VCR would destroy the movie business, video and DVD rentals and sales currently generate substantially more revenue than movie theaters.¹⁰ When industry executives cannot accurately predict the direction of the market, a legal standard that asks the Federal courts to engage in such predictions has little to recommend itself.

The iPod, which has been responsible for the resurgence of Apple, has a similar story line. Apple first invited customers to “rip, mix, and burn” their favorite music when releasing its iTunes software in January 2001 and then embedding it on the latest version of the iMac personal computer.¹¹ The iPod followed later that year,

⁶ See, e.g., *Cable/Home Communication*, 902 F.2d at 837–39 (active promotion of television signal de-scrambling chips); *Sega Enters. Ltd. v. MAPHIA*, 948 F. Supp. 923, 933 (N.D. Cal. 1996) (Internet bulletin board operator actively encouraged users to upload copyrighted games).

⁷ NVCA takes no position on whether, on the record here, the defendants in *Grokster* materially assisted or encouraged specific acts of infringement.

⁸ The prospect of such litigation is far from theoretical. In addition to suing Napster, for example, the recording industry has brought suit against venture capital firms and other investors that provided early funding. See *In re Napster, Inc. Copyright Litig.*, Nos. C–MDL–00–1369–MHP & C–04–1166–MHP, 2005 WL 273178, at *1 (N.D. Cal. Feb. 03, 2005) (discussing suit versus venture capital firm Hummer Winblad Venture Partners); *UMG Recordings, Inc. v. Bertelsmann AG*, 222 F.R.D. 408, 413–14 (N.D. Cal. 2004) (discussing suit against investor Bertelsmann). Indeed, after driving *mp3.com* into bankruptcy and acquiring its assets, the studios have even brought suit against the lawyers that performed corporate work for *mp3.com* in its start-up phase. Jon Healey, *MP3.com Sues Former Copyright Counsel*, *L.A. Times*, Jan. 19, 2002, at C2. These scorched-earth litigation tactics are expressly designed to discourage the development of any product that is capable of infringing uses—a complete inversion of the *Sony* rule.

⁹ See Mark A. Lemley & R. Anthony Reese, *Reducing Digital Copyright Infringement Without Restricting Innovation*, 56 *Stan. L. Rev.* 1345, 1388 (2004) (discussing how the threat of liability has deterred innovation among computer programmers); Joseph P. Liu, *The DMCA and the Regulation of Scientific Research*, 18 *Berkeley Tech. L.J.* 501 (2003) (discussing ways in which threat of liability under the Digital Millennium Copyright Act deters innovation in field of encryption); Assaf Hamdani, *Who's Liable for Cyber-wrongs?*, 87 *Cornell L. Rev.* 901 (2002) (demonstrating that threat of secondary liability has led to over-deterrence); Matthew Fagin, Frank Pasquale & Kim Weatherall, *Beyond Napster: Using Antitrust Law to Advance and Enhance Online Music Distribution*, 8 *B.U. J. Sci. & Tech. L.* 451, 500 (2002) (“Innovation in the technologies of distribution will decline markedly if potential new innovators are chilled by a threat of legal action”).

¹⁰ See note 8, *supra*.

¹¹ See Dennis Sellers, *Jobs: iTunes Is New, Free Jukebox Software* (Jan. 9, 2001), available at <http://www.macworld.com/news/2001/01/09/itunes/index.php>. The first mp3 commercial players were developed several years earlier, and the music industry immediately filed suit to enjoin their sale. See *Recording Indus. Ass'n of Am. v. Diamond Multimedia Sys., Inc.*, 180 F.3d 1072 (9th Cir. 1999) (suit against Rio portable mp3 music player). It is only because of the legal

with an initial 5 gigabit version that could hold up to 1,000 songs. Apple was immediately attacked by the major studios and accused of inciting theft.¹² But it was not until April 2003 that Apple launched its iTunes online music store, after reaching agreements with all of the major studios to sell the ability to download individual songs or entire CDs. In the first quarter of 2005 alone, Apple reported licensed online music sales of roughly \$275 million, and it is now selling 1.25 million songs *per day*. Just as licensed video sales and rentals have eclipsed movie theaters in revenues, it appears clear that licensed online downloads will eclipse CDs. But neither could do so without the protection afforded by *Sony* for mixed-use technologies.

Peer-to-peer sharing is likely to provide yet another example if permitted to develop. Thanks to a file-sharing technology called BitTorrent, millions of users were able to quickly download and view “lengthy amateur videos documenting the devastation of the December tsunami in the Indian Ocean, helping to spur an outpouring of charitable aid.”¹³ BitTorrent’s main use, however, appears to be among those who want to trade Hollywood movies and TV shows, thus “putting it in the cross hairs of the entertainment industry.”¹⁴ The technology obviously is capable of substantial non-infringing uses; subjecting the inventor to ruinous liability would deprive the marketplace and consumers of the opportunity to develop a legitimate market for those uses.¹⁵

Conclusion

The clear rule of law that the Supreme Court articulated in *Sony* has provided the backdrop for an unprecedented period of technological growth and innovation. That revolution in informational technology, in turn, has been responsible for the creation of millions of jobs in the United States, directly and indirectly contributing billions of dollars to the GDP. Replacing the *Sony* rule with a more amorphous, fact-specific standard, as advocated by many in the entertainment industry in *Grokster*, would have placed these industries, and the nascent businesses that are their life blood, at risk. The Supreme Court refused to go down this path. Supreme Court Justice Stephen Breyer along with Justices Sandra Day O’Conner and John Paul Stevens argued that “*Sony*’s rule is strongly technology protecting. . . . *Sony* thereby recognizes that the emergence of new technologies, including (perhaps especially) those that help disseminate information and ideas more broadly or more efficiently.”

The market, rather than the Federal courts, should drive investment decisions. Unfortunately, the Supreme Court left many liability questions unanswered in *Grokster*, and those issues will now have to again be addressed by the lower courts in continuing litigation. For venture capital firms, the additional layer of legal uncertainty—a risk that can be neither measured nor managed—will discourage investment in critical information technologies in the near term post *Grokster*. We have now an opportunity for a breathing space, one in which technologies can continue to emerge and further answers emerge from the courts without a rush to judgment from any sector, whether it is the entertainment industry, Congress or investors. However, if the entertainment industry decides to initiate even greater volumes of litigation against inventors and investors, Congress may need to return its focus to this issue.

Thank you again for the opportunity to testify here today on these critical issues. I look forward to answering any questions.

The CHAIRMAN. Thank you.

Our next witness is Dave Baker, Vice President, Law and Public Policy, of EarthLink. EarthLink is an Internet service provider with over five million subscribers.

protection afforded by this Court’s *Sony* decision that the iPod could be developed, marketed, and released.

¹² See Brooks Boliek, *Mouse Grouse: Dis Boss Lays Into Computer Biz*, *The Reporter.com*, Mar. 1, 2002, available at http://www.larta.org/pl/NewsArticles/02Marc01_HR_Eisner.htm.

¹³ Jonathan Krim, *High-Tech Tension Over Illegal Uses*, *Wash. Post*, Feb. 22, 2005, at E1, available at <http://www.washingtonpost.com/wp-dyn/articles/A42401-2005Feb21.html?sub=AR>.

¹⁴ *Id.*

¹⁵ While the United States and petitioners contend that it would be more efficient for users seeking publicly available material to go directly to the website that houses it than to use peer-to-peer file-sharing software, neither has offered any evidence to support this factual assertion. The Ninth Circuit, by contrast, found that peer-to-peer arrangements “significantly reduced] the distribution costs of public domain and permissively shared art and speech.” Pet. App. 16a. While legitimate arguments may support these competing conclusions, the prior question that the United States fails to address is whether the Federal courts have the institutional capabilities to weigh the competing evidence in such complex areas as computer software and the life sciences. The marketplace performs this same function automatically.

Mr. Baker?

**STATEMENT OF DAVID N. BAKER, VICE PRESIDENT,
LAW AND PUBLIC POLICY, EARTHLINK, INC.**

Mr. BAKER. Thank you.

Chairman Stevens, Co-Chairman Inouye, and members of the Committee, thank you for inviting me to testify today.

I'm Dave Baker. I'm Vice President for Law and Public Policy with EarthLink. EarthLink is one of the Nation's largest Internet service providers, serving 5.4 million customers with broadband, dial-up, web-hosting, wireless Internet, and voice services.

We appreciate this committee's interest in peer-to-peer file sharing and the issues related to the Supreme Court's recent decision in *MGM v. Grokster*. You will hear from other witnesses today about the importance of protecting copyrights. EarthLink agrees and supports the rights of copyright owners to protect their intellectual property and to do so in a manner that does not compromise the ability of Internet providers to deliver broadband and other Internet services to as many Americans as possible.

Indeed, if we are to realize the promise of the emerging broadband future, we should all want to develop means to make online music, movies, and video more widely available to consumers while protecting the copyrights of those who create such content.

In studying the issues of peer-to-peer file sharing, I would like to offer the Committee some insights from our experience with the Digital Millennium Copyright Act. The goal of the DMCA is to give copyright owners a mechanism to protect their intellectual property from online infringement while creating counter-notification safeguards for website owners and a safe-harbor provision for ISPs. The DMCA affirms the longstanding principle that ISPs are but conduits for information. As such, they are not liable for the content that travels over their networks.

Having said that, EarthLink, as other ISPs, does not tolerate activities which violate copyrights. Where ISPs host websites which contain infringing content, we can, and do, play a part in protecting copyrights.

Under the DMCA's notice and takedown provisions, an ISP will disable or block access to a website it hosts if it receives a notification of a good-faith belief that such website infringes a party's copyrights. The website owner has a similar opportunity to file a counter-notification to get his website restored. The DMCA's notice and takedown procedure has worked well for over 6 years. ISPs like EarthLink handle DMCA notices almost every day. Copyright owners are given reasonable opportunity to protect their intellectual property. Website owners are given reasonable opportunity to protect their content. And ISPs are given reasonable opportunity to aid copyright owners without themselves becoming liable for content they host.

However, ISPs faced challenges a few years ago when copyright owners tried to stretch the use of the DMCA to include peer-to-peer file sharing. The RIAA tried to use the subpoena power of Section 512(h) to require ISPs to divulge the identity of Internet users who were alleged to have transmitted copyrighted materials across the

ISP's network. Using the DMCA in this fashion allowed administrative subpoenas to be issued in blank, with no judicial oversight.

Compounding this problem were the use of bots, automated programs which scour the web looking for files which contain names of copyrighted materials. But bots are indiscriminate. For instance, a notice sent in 2001 to UUNet sought to cutoff Internet access to all users who had downloaded files containing "Harry Potter." One of these files was titled *harry_potter_book_report.rft* and was, in fact, just what it purported to be, a child's book report on Harry Potter, yet the notice, if enforced, would have cutoff all Internet access, not just for this child, but for his or her entire family.

Unlike websites, which ISPs host and can, therefore, control access to, peer-to-peer files reside on the computers of individual Internet users. Short of canceling the accounts of all of these users, which would work in undue hardship, ISPs cannot control this. What's more, attempts to force ISPs to disclose the identity of individuals upon a mere allegation of copyright infringement unnecessarily compromises the privacy of all Internet users.

As EarthLink has stated many times before, we support the rights of the RIAA and other copyright owners to protect their intellectual property. We just must do so in a way that protects the privacy of legitimate users and which does not shoot the messenger, the ISP, which makes online communications possible in the first place.

In the *Grokster* case at hand, the Supreme Court unanimously held that Grokster and StreamCast are potentially liable for copyright infringement by their users. The court focused on the element of intent to induce infringement.

Further, the court held that Grokster and StreamCast did not meet the *Sony* standard of commercially significant non-infringing use, and the overwhelming evidence of an intent to induce infringement could not be disregarded. The Supreme Court went on to say that the *Sony* standard remains, but it also said that you cannot use the *Sony* safe harbor if you are clearly inducing others to infringe copyrights.

As the Supreme Court noted, peer-to-peer is an immensely useful technology. The lesson from the *Grokster* case is not to limit the technology, but to use it in a way that does not intentionally infringe on copyrights.

As I noted in the foreword I wrote to the Giga Law Guide to Internet Law regarding Grokster's predecessor, Napster, Napster provides a great example of a killer app, killed by its failure to address legal realities. A brilliantly simple application, it took full advantage of the Internet's very nature as an information service to create a means of distributing music far more efficiently than the conventional process of pressing and shipping CDs. But as good as its technology was, Napster failed to address vital legal issues. Rock stars, songwriters, and music publishers are entitled to be paid for their work, as Federal courts in the Napster lawsuit repeatedly ruled. Napster, and now Grokster, will always serve as a reminder that just because you can do something online doesn't mean you can ignore existing laws.

I thank the Committee, again, for inviting me here today, and I look forward to any questions you may have.

[The prepared statement of Mr. Baker follows:]

PREPARED STATEMENT OF DAVID N. BAKER, VICE PRESIDENT,
LAW AND PUBLIC POLICY, EARTHLINK, INC.

Chairman Stevens, Co-Chairman Inouye and members of the Committee, thank you for inviting me to testify today. My name is Dave Baker and I am Vice President for Law and Public Policy with EarthLink. Headquartered in Atlanta, EarthLink is one of the Nation's largest Internet Service Providers (ISPs), serving approximately 5.5 million customers with broadband, dial-up, web hosting, wireless Internet and voice services.

We appreciate this committee's interest in peer-to-peer file sharing and the issues related to the Supreme Court's recent decision in *MGM v. Grokster*. You will hear from other witnesses today about the importance of protecting copyrights. EarthLink supports the rights of copyright owners to protect their intellectual property and to do so in a manner that does not compromise the ability of Internet providers to deliver broadband and other Internet services to as many Americans as possible. Indeed, if we are to realize the promise of the emerging broadband future, we should all want to develop means to make online music, movies and video more widely available to consumers while reasonably protecting the copyrights of those who create such content.

In studying the issue of peer-to-peer file sharing, I would like to offer the Committee some insights from our experience with Federal copyright legislation. In 1998, Congress passed the Digital Millennium Copyright Act (DMCA). The goal of the DMCA is to give copyright owners a mechanism to protect their intellectual property from online infringement while creating safeguards such as counter-notification procedures for website owners and a safe harbor provision for ISPs.

The DMCA affirms the long-standing principle that ISPs are but conduits for information. As such, they are not liable for the content that travels over their networks. Having said that, EarthLink, as other ISPs, does not tolerate activities which violate copyrights. Where ISPs host websites which contain infringing content, they can and do play a part in protecting copyrights.

Under the DMCA's notice and takedown provisions, an ISP will disable or block access to a website it hosts if it receives a notification of a good-faith belief that such website infringes a party's copyright(s). The website owner has a similar opportunity to file a counter-notification to get his website restored.

The DMCA's notice and takedown procedure has worked well for over 6 years now. ISPs like EarthLink handle DMCA notices almost every day. Copyright owners are given reasonable opportunity to protect their intellectual property, website owners are given reasonable opportunity to protect their content, and ISPs are given reasonable opportunity to aid copyright owners without themselves becoming liable for content they host.

However, ISPs faced challenges a few years ago when copyright owners tried to stretch the use of the DMCA beyond notice and takedown of hosted websites to include peer-to-peer file sharing. The RIAA tried to extend the subpoena power of Sec. 512(h) of the DMCA to require ISPs to divulge the identity of Internet users (not necessarily even customers) whom the RIAA alleged to have transmitted copyrighted materials across the ISP's network.

Using the DMCA in this fashion allowed administrative subpoenas to be issued in blank with no judicial oversight. Compounding this problem was the use of "bots", automated programs, which scour the web looking for files which contain names of copyrighted materials. But these bots are indiscriminate in both the breadth and specificity of the information they seek. For instance, a subpoena sent by *copyright.net* to UUNet on January 2, 2001 sought personally identifying information for 2,635 individual subscribers. And in another example, notices sent by Mediaforce to UUNet on December 3, 2001 sought to cutoff Internet access to all users who had downloaded files containing "Harry Potter." One of these files was titled *harry_potter_book_report.rtf* and was 1k in size. Not only was this magnitude smaller than even the legal clips of the movie, much less the megabytes needed for bootleg copies of the whole film, but closer inspection showed it to be just what it purported to be, a child's book report on Harry Potter. Yet the notice, if enforced, would have cutoff all Internet access not just for this child, but for his or her entire family.

Unlike websites which ISPs host, and can therefore control access to, peer-to-peer files reside on the computers of individual Internet users. Short of canceling the accounts of all these users, which would work an undue hardship, ISPs can not control this. What's more, attempts to use the ministerial subpoena power of the DMCA to

force ISPs to disclose the identity of individuals upon a mere allegation of copyright infringement unnecessarily compromises the privacy of all Internet users.

As EarthLink has stated many times before, we support the rights of RIAA, the MPAA and other copyright owners to protect their intellectual property. But the DMCA must not be used in ways that compromise the privacy of Internet users more than it would protect copyrights.

In sum, we have to balance protecting the intellectual property of copyright owners while protecting the privacy of Internet users, all while not shooting the messenger (ISPs) that provide the very access that makes online communications possible.

In the *Grokster* case at hand, the Supreme Court unanimously held that Grokster and StreamCast are potentially liable for copyright infringement by their users. The Court focused on the element of intent, holding 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.”

Further, the Supreme Court held that Grokster and StreamCast did not meet the *Sony* standard of “commercially significant non-infringing use” and the overwhelming evidence of intent to induce infringement could not be disregarded. Said the Court, “Here, evidence of the distributors’ words and deeds going beyond distribution as such shows a purpose to cause and profit from third-party acts of copyright infringement.” The Supreme Court went on to state that the *Sony* standard of “substantial non-infringing use” remains. But it also stated that one cannot use the *Sony* safe harbor if they are clearly inducing others to infringe copyrights.

Peer-to-peer is an immensely useful technology. As the Supreme Court noted in *Grokster*, there are several advantages to peer-to-peer networks. Because they need no central computer server for users to exchange information, they don’t need the high bandwidth communications capacity a central server would require. Similarly, the need for costly server storage space is eliminated. Since copies of a file (particularly a popular one) are available on many users’ computers, file retrievals may be faster than on other types of networks. And since file exchanges do not travel through a server, communications can take place between any computers that remain connected to the network without risk that a glitch in the server will disable the whole network. Given these benefits in security, cost, and efficiency, peer-to-peer networks are used by universities, government agencies, corporations, and libraries, as well as by millions of individual users.¹ The lesson from the *Grokster* case is not to limit the technology, but to use it in a way that does not intentionally infringe on copyrights.

As I noted in my foreword to the Giga Law Guide to Internet Law regarding Grokster and StreamCast’s predecessor, Napster:

Napster provides a great example of a “killer app” killed by its failure to address legal realities. A brilliantly simple application, it took full advantage of the Internet’s very nature as an information service to create a means of distributing music far more efficiently than the conventional process of pressing a CD, wrapping it, boxing it, shipping it, unloading it, and displaying it in a store just so a customer could drive to that store, buy the CD, take it home, and put it in a player to decode the CD’s digital information in order to finally hear music. But as good as its peer-to-peer file-sharing technology was, Napster failed to address vital legal issues such as copyrights, licenses, and royalty payments. Rock stars, songwriters, and music publishers are entitled to be paid for their work, as the Federal courts in the Napster lawsuits repeatedly ruled. Napster will always serve as a reminder that just because you can do something online doesn’t mean you can ignore existing laws.²

I again thank the Committee for inviting me here today and I look forward to any questions you may have.

The CHAIRMAN. Well, thank you very much.

The next witness, Mitch Bainwol, Chairman and CEO of the Recording Industry Association of America. This is a trade group representing the U.S. recording industry and its members. They’re re-

¹ *MGM v. Grokster*, 545 U.S. _____ (2005) at 1–2.

² *The Giga Law Guide to Internet Law* by Doug Isenberg. Random House Trade Paperbacks 2002 at xi.

sponsible for approximately 90 percent of all legitimate sound recording produced and sold in the United States.

Mr. Bainwol?

**STATEMENT OF MITCH BAINWOL, CHAIRMAN AND CEO,
RECORDING INDUSTRY ASSOCIATION OF AMERICA**

Mr. BAINWOL. Thank you, Mr. Chairman, Mr. Co-Chairman, Senator Smith, Senator Kerry, and Senator Pryor. I appreciate the opportunity to testify here today.

I am the CEO of the RIAA. Sometimes I think we should be called the MVCA, instead, the Music Venture Capital Association, because that's what record companies do. We invest in music. We put the proceeds from the sale of recorded music back in to new art. It's a risky business, and it doesn't pay off all the time, but, when it does, it's a great experience, and we're able to generate this wonderful music for fans across the globe.

Two things make all of this work. First, there is no substitute for quality music. The product has to sell. Second, you have to be able to do just that: sell. An investment-based business that cannot reap the value of its investment is a business that cannot sustain itself. It's that simple. That's why these past few years have been tough and why we're hopeful about the coming years. In 1999, the domestic sale of music reached nearly \$15 billion. By 2003, that figure had plummeted to under \$12 billion. 2004 was pretty much flat, and 2005 is down again, another 7 percent. Much, but not all, of the problem is due to Internet piracy. Piracy sounds romantic, but if you work in the music business, it's anything but. Piracy is a job killer, it's a culture killer, it's a lesson learned by a generation that stealing is OK.

Our beef, though, is not with the Internet, and it sure isn't with technology. Our beef is with the conduct—the conduct of bad actors who built a business by giving away our property for free and then making money from spyware and from advertising. That's precisely what *Grokster* is all about. The case centered on whether these bad actors could pull what I call the Sergeant Schultz defense, “see nothing, do nothing,” but profit all along from the infringement that they encourage. It's a business model predicated on theft.

We felt good about the oral arguments in March. We had 40—40 state attorneys general with us. We had the Solicitor General speaking for the U.S. Government on our side. We had property-rights groups, technology groups, family groups, artists, and broad editorial support. Our mainstream position won out, as the Vice President once said, big time. With a nine-zero ruling by a court that can't agree on what to have for lunch, a clear message was sent, “Thou shalt not steal, and businesses that profit by encouraging others can't evade liability.” It was stunning. From Ginsburg to Scalia, from Stevens to Rehnquist, from Thomas to the most tech-savvy guy on the bench, Breyer, everyone—everyone agreed.

The majority opinion, written by Souter, said it all, “The unlawful objective is unmistakable. This case is significantly different from *Sony*. *Sony* dealt with a claim of liability based solely on distributing a product with an alternative lawful and unlawful uses. Here, evidence of the distributor's words and deeds going beyond

distribution shows a purpose to cause and to profit from third-party acts.”

When confronted with a tension between two important values, creativity and innovation, the court struck a perfect balance. Tech voices like Apple, HP, and even Mark Cuban, who funded the *Grokster* defense, applauded the decision. So did we. Editorials echo that praise. Imagine, *The New York Times* and *The Wall Street Journal* singing together. *The Washington Times* and *The Washington Post* hitting the same note, more rare than even a nine-zero decision. As my fellow panelist Mark Heesen properly observed, only those players who willfully promote copyright infringement will be subject to potential liability.

So, what does the decision mean? It means that similarly situated businesses that encourage infringement need to do some serious reflection, and they need to do that fast, and reach the obvious conclusion that it’s time to go straight or face the consequences. It means venture capital will flow to technology companies, like Mr. Kerber’s, that respect property and reward the future of music. It means nascent technologies that operate within the law will have a chance to get traction, attract investors, and appeal to fans. It means that we increasingly will be able to sell and invest in new artists and more music. And that’s why we’re optimistic about the future.

Two years ago, there was no legitimate digital marketplace. We’re watching the rapid emergence of a quintessentially American dynamic competition in this space—iTunes, Real, Napster, Wal-Mart, and others competing for the download segment of the market; Yahoo!, Rhapsody, Napster, and others competing for the subscription segment of the market; Wurld, iMesh, Mashboxx, P2P Revolution, and others competing for the important legitimate peer-to-peer market.

And the wireless market, already advanced around the world, is poised to take off here, as well. *Grokster* plays into this dynamic in a very big way, legally and culturally. Legally, those who don’t play by the rules know that the Sergeant Schultz defense won’t fly any more. If it walks like a duck and quacks like a duck, you know you’ve got a turkey. And, culturally, we’ve pierced the nonsensical notion that somehow the taking of property is OK when it comes to music.

All we want is a chance to compete. No one thinks that our road to recovery is easy or automatic. But a chance for our investment to earn a return is a pretty darn good first step.

Thank you for listening.

[The prepared statement of Mr. Bainwol follows:]

PREPARED STATEMENT OF MITCH BAINWOL, CHAIRMAN AND CEO,
RECORDING INDUSTRY ASSOCIATION OF AMERICA

Mr. Chairman, Co-Chairman Inouye, I appreciate the opportunity to testify today on the Supreme Court’s *Grokster* decision.

One month ago, the Court took a major step toward safeguarding and advancing one of this country’s greatest resources—intellectual property. In a rare 9–0 decision, the Justices held unanimously in *Grokster* that those who encourage others to steal may be held liable themselves. The resulting message is straightforward and simple: theft, in any medium, is unacceptable.

Grokster is a peer-to-peer (P2P) file-sharing network that allows members to copy songs, movies, software, and other creative works over the Internet without paying

for them. The result has been, in the words of the Supreme Court, “infringement on a gigantic scale.” These illicit networks have enabled the illegal copying of millions upon millions of *exact* duplicates of valuable works with the click of a mouse. Every day.

This massive theft has been particularly devastating for the music industry. In 1999, the domestic sale of music reached \$14.5 billion. By 2003, that figure had plummeted to \$11.8 billion. 2004 was virtually flat, and 2005 is down again, another 7 percent. Record companies are essentially venture capitalists, investing proceeds from the sale of recorded music back into new artists. It’s a risky business, with only about a 10 percent success rate. Yet, releases from the most popular artists (which make up most of that successful 10 percent) 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. The top 100 albums sold 194.9 million units in 1999, compared to 153.3 million units in 2004. The result is less money to invest in new artists and new music.

A handful of studies have shown the direct correlation between illegal file-sharing and this decline in sales. David Blackburn of Harvard University found that “file sharing has had large, negative impacts on industry sales.”¹ Stanley Liebowitz of the University of Texas at Dallas concluded that, “there is strong evidence that the impact of file-sharing has been to bring significant harm to the recording industry.”² Other researchers have echoed similar findings.

Piracy sounds romantic, but not if you work in the music business. It’s a job killer. In addition to the decline in artist rosters, there have been thousands of layoffs of industry employees, and hundreds of shuttered music store doors. The effect of illegal file-sharing has been felt by songwriters, technicians, artists, and musicians, not to mention filmmakers, programmers, and scores of others who make their living from the creation and lawful sale of their products. The U.S. economy and the industries that employ over 5 million Americans have taken a massive hit from the billions of dollars lost annually through illegal file-sharing. Further, piracy on these networks is teaching an entire generation that stealing is acceptable.

It’s not. Unfortunately, standing against theft in the digital world has provoked some to label us anti-technology or against innovation. Such claims may make for good soundbites, but they are far from the truth. Technology is making the music experience better and better. From iTunes to ringtones, the music industry is continuously looking for new ways to get music to fans and is embracing new technology that allows for the widest lawful distribution of creative works.

The problem is with the behavior of bad actors who have used this amazing P2P technology to build businesses predicated on theft. They have reaped millions—and, indeed, stayed in business—by giving away our property and the property of thousands of others for free, receiving revenue from third party spyware and advertising aimed at those looking to steal. It has been estimated that over 90 percent of the file-sharing on Grokster and similar services is illegal copyright infringement. This is no accident. The more songs, movies, computer games, and other creative works that are stolen through their network, the more money these services make. As the Court noted, “the unlawful objective is unmistakable.” Without this illegal downloading, these services go broke. This is an unacceptable business model.

And that’s precisely what the Grokster case was all about. The Court recognized that companies, like Grokster, that provide the tools and promote massive online infringement must be held responsible. As Senator Patrick Leahy observed, “This decision means that companies can no longer, with a wink and a nod, absolve themselves from any responsibility for what their products do. Just as consumers bear a responsibility for using these products to illegally download files, the companies that fashion and promote these tools must share in that obligation.”

The Court also noted the need for legitimate technological innovation and creativity, saying that their ruling “does nothing to compromise legitimate commerce or discourage innovation having a lawful purpose.” This is not about technology. The decision of the Court was technology-neutral, focusing instead on behavior and separating the good actors from the bad actors. It put the emphasis exactly where it should be—on those who “encourage infringement” while looking the other way as they reap the rewards.

The Court did not alter the standard established in its 1984 *Sony* case. In its own words, “nothing in *Sony* requires courts to ignore evidence of intent if there is such evidence, and the case was never meant to foreclose rules of fault-based liability derived from the common law.” Grokster and other bad actors can be held liable with-

¹“On-line Piracy and Recorded Music Sales,” David Blackburn (2004).

²“File Sharing: Creative Destruction or Just Plain Destruction?” Stanley Liebowitz (2005).

out threatening legitimate technological innovation or the *Sony* standard that has served creators and consumers so well.

Our position in this case was bolstered by incredibly wide-ranging support. The coalition against Grokster's enabling of intellectual property theft includes the creative community, the law enforcement community, the family values community, and the technology community. During the *Sony* case in the 1980s, 20 Attorneys General from around the country were with the other side; this time, 40 were with us. The U.S. Government filed on our side with a compelling brief by the Solicitor General. Key Members of Congress, property rights groups, family groups, artists, technology companies, and others also filed in support of protecting property rights. There was enormous editorial support, from *The New York Times* and *The Wall Street Journal* to the *Washington Times* and *The Washington Post*. Broad consensus, capped off with a unanimous Court decision.

Those who still claim that the law is not clear are few and far outside the mainstream. This is now a settled question. File-sharing copyrighted works without permission is illegal; encouraging it is also illegal. *Sony* is not a "get out of jail free" card. It will not protect you if you encourage theft. Grokster and similarly situated businesses that enable infringement need to realize that it's time to go straight or face the consequences.

The turn of the new millennium, and the emergence of file-sharing, marked the first stage of P2P—an era of lawlessness where the excitement of a new medium and a lack of viable legal online alternatives paved the way for massive online theft. The second stage brought ambiguity, as education and enforcement of copyright by content owners was continuously thwarted by the misinformation and lure of free goods from Grokster and others. Now, with the decision of the Supreme Court, we have entered the third stage—and the bright future—of legal, responsible P2P file-sharing.

The legal and moral clarity provided by the *Grokster* decision is a shot of adrenaline for the legitimate marketplace. Capital will now naturally flow to technology companies that respect property and reward the future of music—companies such as iMesh, Snocap, Mashboxx, and Passalong, as well as Wurld Media, who is represented at this hearing today. In other words, the purpose of intellectual property protection as an investment lure is being met. Nascent technologies that operate within the law will have a chance to gain traction, attract investors, and appeal to fans. And we can increasingly sell, and thus invest, in new art, benefiting creators and consumers alike.

We are optimistic about the future. Two years ago, there was no legitimate digital marketplace to speak of. Today, we are watching the rapid emergence of quintessentially American competition for this new marketplace. iTunes, BuyMusic, Wal-Mart, Sony Connect and others are battling it out for the download segment of the market. The result: in March 2005, 26 million songs were purchased from digital music stores in the United States.³ Yahoo!, Rhapsody, Napster, MSNMusic and others are battling it out for the subscription segment of the market. Many of the above and others offer both. Forty-three percent of music downloaders in 2005 have tried legitimate online music services⁴ and 34 percent of current music downloaders say they now use paid services.⁵ On college and university campuses across the country—hotbeds of illegal activity on exceedingly fast networks—administrations and students are embracing the legitimate offerings of these services and others.

More than 50 schools have entered into deals with companies like Ruckus Networks. Just last week, the University of California and California State networks signed with Cdigix, potentially providing hundreds of thousands of new students with the opportunity to legally obtain music and movies on campus. And, of course, the wireless market, already advanced elsewhere around the world, is poised to take off here as well.

But these legitimate businesses are able to thrive only by controlling the illicit services that directly compete with them. *Grokster* plays into this dynamic—legally and culturally. Legally, those who don't play by the rules know that it is no longer acceptable to reap ill-gotten gains while burying their head in the sand. And, culturally, we've pierced the nonsensical notion that somehow the taking of property is acceptable when it's music. All we want is a chance to compete, a chance for our investment to earn a return, and a chance to make great music for fans everywhere.

Thank you.

³NPD MusicWatch Digital Service.

⁴Pew Internet and American Life study, March 2005.

⁵Pew, March 2005.

The CHAIRMAN. Thank you.

Last witness, Fritz Attaway, Executive Vice President, Motion Picture Association of America, serving as the voice and advocate of the American motion picture, home video, and television industries.

Thank you. Mr. Attaway?

**STATEMENT OF FRITZ E. ATTAWAY, EXECUTIVE VICE
PRESIDENT AND WASHINGTON GENERAL COUNSEL,
MOTION PICTURE ASSOCIATION OF AMERICA**

Mr. ATTAWAY. Thank you, Mr. Chairman, Co-Chairman Inouye, Senator Snowe, Senator Smith, Senator Kerry, Senator Pryor. I'm very pleased to be here today to represent myself, Dan Glickman, the members of the Motion Picture Association and present our views on this landmark decision.

I wish I would have brought my kiddie seat, but I'm very pleased to be here today.

It should be of particular interest to this committee that the best way I know of to characterize this Supreme Court decision is that it is good for commerce and it is good for consumers. The Court's unanimous decision, like the adoption of the Digital Millennium Copyright Act, establishes a rational and balanced basis for the evolving digital environment which will remove uncertainty and spur investment in creative content and the technology with which it is created, delivered, and displayed. As a result, consumers will have more and better viewing choices. It is a win-win-win decision.

And, contrary to what Mr. Eisgrau suggested, there is no need to bring the parties together in the wake of this decision. The legitimate content distributors and the content creators are talking, as Mr. Kerber will attest to. What was needed is to get the free-riders out of the way, which this Supreme Court decision will go a long ways in doing, and allow the legitimate business interests to proceed with new viewing choices for consumers.

In its *Grokster* decision, the Court declined to revisit the *Sony* case decided almost a decade earlier, but did provide very important clarification. It said, as it did in *Sony*, that the mere manufacture and distribution of a device with knowledge that it may be used to infringe does not create liability; however, it went on to say that where there is evidence of purposeful, culpable conduct directed at promoting infringement, liability does attach. In the case at hand, the Court found that defendants had marketed their services to an audience likely to commit infringing acts, had taken no steps to prevent infringement, and had profited from the infringing acts of their customers. The court struck a careful balance between the need to foster creative content and the need to encourage technological innovation. Its rational balance has been recognized both by the content and the technology communities, receiving praise not just from MPAA and RIAA, but also from the Information Technology Industry Council and the Business Software Alliance, organizations that represent many of the major high-tech companies in the United States.

In clarifying its *Sony* decision, the *Grokster* court stressed the importance of secondary liability to meaningful application of the copyright law. The Court said that, in the digital environment,

rights against direct infringers may be impossible to enforce, and that remedies for secondary liability may be the only practical means to protect copyrights against massive infringement.

The Court, in *Grokster*, sent a resounding message to users of the Internet, as Senator Inouye pointed out earlier: theft of intellectual property is wrong, whether it takes place by stealing a physical copy of a movie or by stealing a movie in cyberspace, and those who encourage such theft will be held liable.

The Internet provides great opportunities, but the Internet is not, and should not be, an environment immune to the rules of a civil society. The distribution of child pornography is no less vile on the Internet than it is anywhere else. The invasion of personal privacy is no less objectionable on the Internet than elsewhere. And the theft of property is no more acceptable on the Internet than it is offline.

Content owners look to the *Grokster* decision to usher in a new age of cooperation among content providers, technology providers, and ISPs aimed at providing consumers with safe, legal, flexible, and convenient choices for entertainment and information.

Again, I thank you for affording me this opportunity to appear before you, and I look forward to answering your questions.

[The prepared statement of Mr. Attaway follows:]

PREPARED STATEMENT OF FRITZ E. ATTAWAY, EXECUTIVE VICE PRESIDENT AND
WASHINGTON GENERAL COUNSEL, MOTION PICTURE ASSOCIATION OF AMERICA

Chairman Stevens, Co-Chairman Inouye, members of the Committee, thank you for giving me this opportunity to appear before you today on behalf of Dan Glickman and the Motion Picture Association of America.

The decision of the Supreme Court in *MGM v. Grokster*, 125 S. Ct. 2764 (2005), like Congressional enactment of the Digital Millennium Copyright Act, establishes rational and balanced rules for the evolving digital environment which will encourage creativity and technological innovation, and result in more and better choices for consumers.

The DMCA provided content owners tools to maintain the integrity of technological measures essential for the secure delivery of high value content to consumers. It contributed mightily to the market launch of the DVD, which has been the most successful consumer electronics device in history, providing a vast new market for content creators and for consumer electronics device and computer manufacturers, and providing consumers with a new, technologically superior, more convenient option for viewing movies.

The Supreme Court's landmark decision in *MGM v. Grokster* will have a similar effect by providing incentives for constructive innovation and a more secure environment in which to deliver movies, music and other content to consumers over the Internet. It will spur investment in new, legitimate delivery services, which in turn will provide a new source of revenue to content creators and encourage the sale of consumer electronics devices and broadband access. And most importantly, it will stimulate new, easy-to-use consumer options for accessing entertainment and information in a variety of formats through a host of new delivery platforms.

In its *Grokster* decision, a unanimous Supreme Court declined invitations to revisit its narrowly decided, five-to-four decision in the *Sony* case a decade earlier. It made clear, however, that the *Sony* decision does not preclude liability where the conduct at issue goes beyond the mere manufacture and distribution of a device with knowledge that it may be used to infringe. The *Grokster* Court said liability DOES attach when there is evidence of purposeful, culpable conduct directed at promoting infringement. In the Court's words, "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." 125 S. Ct. 2764 at 2780 (2005). Such a ruling is neither extraordinary, nor at odds with long-established rules of fault-based liability derived from the common law. And as the Court made explicit, such a rule "does

nothing to compromise legitimate commerce or discourage innovation having a lawful promise.” *Id.* at 2780.

In other words, the Court stated, as it had in its *Sony* decision, that technology capable of substantial non-infringing uses is not inherently bad, but those who traffic in such a technology with the intent of inducing others to infringe are bad actors and subject to remedies for contributory infringement. It found in the case before it that the defendants had intentionally marketed their software to former users of the Napster “file sharing” service which had been found to be in violation of the copyright laws; had made no effort to limit the infringing activities of their customers;¹ and had established a business model whose success was directly tied to the infringements of their customers. Under these circumstances, the Court said there was a clear basis for a finding of contributory infringement.

In crafting its decision, the Court was sensitive to any possible impact on technological innovation and carefully distinguished between simply knowing that a device could be used to infringe and culpable conduct.² The Court’s careful articulation of what is, and what is not, permissible will remove uncertainty in the marketplace and stimulate capital investment in the technology sector as well as the distribution marketplace. Its success in reaching an appropriate balance that protects both creative and technological innovation is evidenced by the fact that its decision has been overwhelmingly praised by the technology community.³

The standard set by the Court is very similar to the standard set by the Congress in the DMCA, where Congress prohibited trafficking in devices with the purpose of enabling the circumvention of technical measures used to prevent copyright infringements. In drafting the DMCA Congress was careful not to discourage technological innovation or the exercise of “fair use” by consumers, while enabling content owners to use technology to protect their rights. And in the period since enactment of the DMCA there has been no evidence that technological innovation has been suppressed, or that consumers have not been able to engage in fair uses of copyrighted works. Indeed, the Copyright Office has undertaken two exhaustive inquiries into the impact of the DMCA on the exercise of fair use, and has twice concluded that the ability of consumers to exercise fair use has not been impinged.

In clarifying its decision in *Sony*, the Court stressed the importance of theories of secondary liability to ensuring meaningful application of the copyright law. Indeed, the Court recognized that in the environment of cyberspace effective enforcement of rights against direct infringers may be impossible, and the application of remedies for secondary liability may be the only practical means to protect copyrights against massive infringement.⁴

The Court in *Grokster* not only clarified its *Sony* decision, it voiced a very clear message to users of the Internet: theft of intellectual property is wrong, whether it takes place by stealing a physical copy of a movie from a video store or by stealing a movie in cyberspace. As Justice Breyer said in his concurring opinion, “deliberate unlawful copying is no less an unlawful taking of property than garden-variety theft.” 125 S. Ct. 2764 at 2793 (2005).

The Internet has opened up heretofore unimagined opportunities for consumers to communicate and access information. It has dramatically changed our lives. But the Internet is not, and should not be, an environment immune to the rules of a civil society. The distribution of child pornography is no less vile on the Internet than anywhere else. The invasion of personal privacy is no less objectionable on the

¹ “[T]here is no evidence that either company made an effort to filter copyrighted material from users’ downloads or otherwise impede the sharing of copyrighted files.” *Id.* at 2774.

² “We are, of course, mindful of the need to keep from trenching on regular commerce or discouraging the development of technologies with lawful and unlawful potential. Accordingly, . . . mere knowledge of infringing potential or of actual infringing uses would not be enough here to subject a distributor to liability. Nor would ordinary acts incident to product distribution, such as offering customers technical support or product updates, support liability in themselves. The inducement rule, instead, premises liability on purposeful, culpable expression and conduct, and thus does nothing to compromise legitimate commerce or discourage innovation having a lawful promise.” *Id.* at 2780.

³ “This decision strikes a balance between encouraging innovation and discouraging piracy.” Statement of Rhett Dawson, President of the Information Technology Industry Council, June 27, 2005. “The application of this new standard should make a real and positive difference in combating online piracy.” Statement of Robert Holleyman, President and CEO of The Business Software Alliance, June 27, 2005.

⁴ “The argument for imposing indirect liability in this case is, however, a powerful one, given the number of infringing downloads that occur every day using StreamCast’s and Grokster’s software. When a widely shared service or product is used to commit infringement, it may be impossible to enforce rights in the protected work effectively against all direct infringers, the only practical alternative being to go against the distributor of the copying device for secondary liability on a theory of contributory or vicarious infringement.” 125 S. Ct. 2764 at 2776 (2005).

Internet than elsewhere. And the theft of property is no more acceptable on the Internet than it is off-line.

In *Grokster* the Court made a clear and forceful statement that theft on the Internet is wrong and the law provides remedies against both those who engage in Internet theft and those who entice others to steal copyrighted works. Content owners hope that *Grokster* will usher in a new age of cooperation among content providers, consumer electronics manufacturers, information technology providers and ISP's, all aimed at providing consumers with legal, flexible and convenient choices for entertainment and information.

The CHAIRMAN. Yes, we have a vote on, gentlemen, unfortunately. We'll stand in recess for about 10–15 minutes, until we get back, please. Thank you.

[Recess.]

The CHAIRMAN. I'm sorry for the delay.

Mr. Kerber, you mentioned there could be appropriate initiatives to follow up on the Supreme Court decision that would solve some of the problems. What do you mean?

Mr. KERBER. I think what gets mixed up in the whole concept of this—and, as I said, I'm a business person, the problem has never been technology, in our experience with the entertainment industry. When we went to the—I'm going to just use this as an example—when we went to the entertainment industry, we are as—about—far out on the outside of the—I wouldn't know a record executive if I fell over the top of him at that point when we had gone to the entertainment industry, and the labels. And what we did was, we went in with a demonstrated business model that we thought would make money within the industry. We thought that if you do certain things, this model will work on the consumer basis it's compelling to give the consumer.

Now—then what we did was, we went and said, “This is the technology we're going to put underneath this business model in order to enable it.” And it was received with every major label in most of the indies and moving on to all of the other digital media opportunities we have.

I think a lot of times what is mistaken here, and I say the appropriate—I think you have to go in—these people are business people, they run publicly traded companies, they have responsibilities to their shareholders. They have to be sure that the folks that they're doing business with will succeed. If you're in business, you want your partners to succeed. And I think that there's just a lot of misconception out there. So when I say the appropriate—being appropriate about it is following the right protocol in order to gather up these folks and become partners in the distribution of digital media.

The CHAIRMAN. I'm really looking for the question of whether any of you at the table will seek to have Congress address this decision and alter the course of events in any way. Any of you seek to have a change, following this court decision, of the way Congress addresses the issue of privacy on the Internet?

Mr. Bainwol?

Mr. BAINWOL. No. We believe the Court struck the right balance, and Congress should leave well enough alone. As Mr. Baker suggested, if we live life a little bit and see that there are issues down the road—but right now it's very clear that you have a very broad consensus. Tech companies are happy. Content's happy. The Court

did the right thing, and they found the right balance, so let's let it go and see how it works.

The CHAIRMAN. But if you own some of those rights, copyrights, would you be happy?

Mr. BAINWOL. We are happy with this outcome. Yes, sir. I mean, that's the point.

The CHAIRMAN. I said if you owned the copyrights, would you be happy?

Mr. BAINWOL. Yes, sir. No, as we—we are companies that have copyrights, and we believe that the right balance was struck here. Our view is that we want to be able to engage in business in the digital space with responsible partners, and those are folks like Greg Kerber, from Wurld Media, who believe that we ought to be compensated for our property. So, there is a way to have a bright future for peer-to-peer that provides music for fans and also provides compensation for creators.

Mr. EISGRAU. Mr. Chairman?

The CHAIRMAN. Yes, sir, Mr. Eisgrau?

Mr. EISGRAU. Thank you, sir.

I would simply note, for the Committee's consideration, that the collective—the voluntary collective licensing model that we're suggesting—which would not require legislation, to answer your question, but probably would require some committee encouragement in order to explore more fully—has the potential to provide revenue to copyright holders, by the millions, who are not presently within the large record-label system. There are many—I can't quantify it for you exactly, Mr. Chairman, but I have to believe there are many songwriters, there are many performers who are out there waiting on tables and working other jobs, perhaps hoping for a record contract, and who are using peer-to-peer to a good degree to get their music out there, but presently, without a voluntary collective licensing setup, there is no way for them to receive compensation. So, to the extent that there is a role for the Committee to play, I suppose the good news for the moment is, it is not legislative with respect to copyrights, but exploration, we believe, of a collective—voluntary collective license of this kind has the potential to maximize peer-to-peer technology not just for the major record labels and companies, of which there are four, soon to be three, but literally for thousands and thousands of individuals. And we hope that's of interest to all of the appropriate committees of jurisdiction, perhaps even small business, that I note a number of members of this committee also sit on, sir.

The CHAIRMAN. Mr.—Heesen?

Mr. HEESSEN. Correct, thank you.

As I said in my statement. We are not coming to Congress to look for any legislative changes here, but we would urge Congress to continue to look at the suits that are filed as a result of this decision, and the numbers that are filed, and, at the appropriate time, if it becomes to the point of another area where the entertainment industry continues to sue and sue and sue, then I think we may have to come back and look at that. But, at this point, we think, as we stated, that there should be some breathing room here and everyone, kind of, look at the decision and let the courts and the marketplace work things out.

The CHAIRMAN. Well, do you believe—do you all believe that we should just, sort of, accept the fact that there's going to be illegal file-sharing, and it will increase over the years?

Mr. Bainwol?

Mr. BAINWOL. Yes—no, sir. We—illegal file-sharing is wrong. It needs to be contained. And we need to—

The CHAIRMAN. How do you—

Mr. BAINWOL.—help foster—

The CHAIRMAN.—propose to do that? How do you propose to do that?

Mr. BAINWOL. Well, with *Grokster*—the *Grokster* decision was a good first step, because it provided moral clarity, and it tells the world and it tells parents and teachers that there's a right way and a wrong way. What we've got to do is de-mythologize this whole question. And you've got companies, like those that my fellow panelist represents, who basically are the equivalent of Jesse James robbing the bank and then coming back to the bank and saying, "we want the franchise to provide security for that bank." They take our property, and then say they want to be licensed. If—there are legitimate players out in the marketplace. They are doing fine with licenses.

Now, what we can do to protect and to move toward a world that is more legitimate is simply to use—we've got to enforce the laws that are on the books. We do that—self-help—we engage in our own litigation to make sure that there's a deterrent. The Government is stepping up in a huge way. The Department of Justice has done a great job in going after these networks. And that's really the secret. We've got to create a society, foster society, where the value of IP is recognized and appreciated and kids are taught that there's a right way to do this, and you ought to pay for it.

Mr. EISGRAU. Mr. Chairman, may I respond? The people I represent were just impugned to a pretty serious degree.

The CHAIRMAN. I'm out of time, but go ahead.

Mr. EISGRAU. Thank you, I appreciate that.

Very briefly, these are very complicated issues, and I have to make a respectful plea for precision in language.

The companies that were at issue in the Supreme Court's decisions, the other companies who are members of Peer-to-Peer United, do not take anybody's property. They are software developers, sir. They have developed pipes, pipes in the way that the Internet is a pipe and broadband connectivity is a pipe. They have created a product that people do, in fact, misuse—and do, in fact, significantly misuse—to infringe the copyrights of the companies Mr. Bainwol represents. But there are no thieves in P2P United, sir. There are companies who have attempted, over years, to work with the labels, going back to 2003. This committee heard evidence a year ago, in the Competition Subcommittee, of potential black-listing by the labels in the form of a deal between RealNetworks and StreamCast, one of the cases—one of the parties to the Supreme Court's case.

So, my point is simply, Mr. Chairman, that we need to be very focused on exactly what this technology is, what kind of actions parties in this space are pursuing. And if we're going to maximize the potential of this technology, then I would respectfully suggest

to Mr. Bainwol that his hope—and Mr. Goldring, the Hollywood music lawyer, backs me on up on this—I would hope that we would look at the realities of the marketplace, not just as we hope they might be, but as they are, and maximize the potential for all copyright holders, not just the institutional ones Mr. Bainwol represents.

The CHAIRMAN. I'm out of time, but I'm really concerned that the Internet service providers seem to be telling us, "Look, we provide this service, but we can't control what goes on, on it." It reminds me of the old story about the piano player in the gambling hall, or the house of you-know-what, not knowing what was going on. Now, you know, somewhere there's a responsibility here to look at the Supreme Court opinion and say that there's a way to move forward and say, "We're not going to condone the illegal use of intellectual property." Now, I don't know where it is, but I hope we can find some response to that.

Senator—

Mr. EISGRAU. You will find that, exactly, on our website, for starters, Mr. Chairman.

The CHAIRMAN. Senator Inouye?

Senator INOUE. Thank you, Mr. Chairman.

Mr. Bainwol, Mr. Attaway, Mr. Eisgrau suggested that this decision will have no practical effect or impact on our marketplace. What are your thoughts?

Mr. ATTAWAY. Senator, I think he is wrong. I think it will have a huge impact on the way that the parties behave and on—ultimately, on the amount of piracy on the Internet. I think this case, even though it was a compromise between the various interests, creates strong incentives for all of the parties, including the ISPs, to work together to address the problem of piracy.

And, to respond to the Chairman's earlier question, I think right now that's good enough. If, ultimately, this decision does not create the appropriate atmosphere to deal with the piracy problem, then I think maybe the Congress does need to act. But, for right now, this decision, I think, provides what we need to deal with—with piracy on the Internet today.

Mr. BAINWOL. Let me just simply add, there are a lot of numbers flying around about usage, and it gets very confusing, because you have files that are spoofed, you've got users that are not real. The best set of numbers that I've seen come from an outfit called MPD, because it's not attitudinal, it's actually a monitor of 10,000 households, so the data's fairly reliable. And what that tells us is, over the past 2 years, the P2P illegal use has gone up just a touch, but has basically been flat, as broadband has gone up by—Mr. Baker, what, by about 50–55 percent in the last couple of years? So, broadband has been soaring, but P2P use has been relatively constant in the very best measure that we can identify.

Two years ago, if you looked at the percent of households that engaged in the legal acquisition of music over the Internet, it was zero, basically zero. That's about 4 percent today. Those lines are going to cross. The illegal household numbers, 9 or 10 percent, that's going to hold flat. With the *Grokster* decision, that will probably even come down. The legal marketplace is going to go up, and

shoot up toward 25–30 percent over time. And the question is how fast those lines intersect.

But *Grokster* provides the societal message that there's a right way and there's a wrong way. Those lines are going to cross sooner as a consequence, and that means we'll be able to invest more in new art.

Senator INOUE. Then your predecessor was wrong, in your mind, as to her comments?

Mr. BAINWOL. I think my predecessor may have been mischaracterized. She has told me that. We believe that, in the end, this is about the marketplace. There's no question. But the question here is whether it's a legitimate marketplace or an illegitimate marketplace. And this decision will help create a day where the legitimate marketplace can take off. That's why it was so important that Mr. Kerber said that, after this decision, venture capitalists started calling him with a greater level of interest. Capital will flow. Once we respect property, then the basis of our great system has a chance to take off.

Senator INOUE. Thank you.

Mr. Kerber, in your testimony, you suggested that your technology will enable you to download—customers to download and share every kind of digital media without viruses, without child pornography, unauthorized content, et cetera, et cetera. You really believe that you can have a pristine environment like that?

Mr. KERBER. Absolutely. We—it's built, and it has been in beta for 7 months, and it's about to go out to the public on Friday of next week.

The bottom line with this, in our minds, from a business standpoint, technology is not the equivalent of anarchy. The thing that is so dynamic and great about technology is—I mean, if you could imagine eBay, and if you could imagine Wal-Mart for that instance, where they lose control of their supply chain and how they would service their customer, the scalability of a peer-to-peer is—there's nothing equivalent to it in the distribution of content. In a centrally controlled peer-to-peer, with what we call traffic cop that knows what's out on the network, and that allows consumers a centralized search with decentralized distribution, meaning that the consumer participates in the distribution, is absolutely doable, and we have succeeded in building that system.

Senator INOUE. Mr. Heesen, you commented that this decision will have an impact upon your investors. It makes no difference what the technology is?

Mr. HEESSEN. Venture capitalists invest in those technologies that they believe, at the end of the day, will give them a significant return on investment for pension funds and colleges' endowments, while, at the same time, making sure that the technologies that they are investing in have as few roadblocks to success as possible. You lower the roadblocks, the more likely the venture capitalist is going to invest in that particular technology.

So, right now we have invested heavily in the life-science area. If suddenly Congress decides to change healthcare policy, you could very easily see that money leave the life-science area and go into another area that has fewer roadblocks.

So, when you have certainty and fewer roadblocks, you are going to have a venture capitalist looking much more seriously at that particular technology, particularly in an area where they think, at the end of the day, there is, once again, a destructive technology out there that can change the way we live, while, at the same time, making a very handsome return for its investors.

Senator INOUE. Would your investors believe that technology to prevent illegal downloading will make money or lose money?

Mr. HEESSEN. You know, frankly, I couldn't tell you what a venture capitalist would be thinking in that mind. I would think that they would be looking at it from the point of view as there is probably thousands of companies trying to do that today, and the venture capitalist would look at it and say, of those thousands of companies, which two or three have the potential to take control of that market and then try to work specifically with those companies to make those companies successful.

Senator INOUE. What are the benefits, Mr. Eisgrau, of this—convening this convention of relevant stakeholders? What would you—what would be the outcome of that now—

Mr. EISGRAU. I appreciate that question.

Senator INOUE.—that people like Mr. Bainwol and Mr. Attaway say it won't work?

Mr. EISGRAU. I think the outcome, first and foremost, Senator, will be knowledge. It will be a group of people convened by the Committee with substantive technical knowledge, with experience in the marketplace, who, with no disrespect to my fellow advocate, Mr. Bainwol, are not simply advocates, but folks who actually understand, in great detail, how the systems might work.

If I might share with you, Senator, in the event that that process somehow did manage to produce a voluntary collective licensing system to serve alongside with every new technology, such as that of World Media, that might come along, no contradiction between that, sir. Let me share just a couple of quick bullet points of what might come about with that sort of a system:

Artists and rights-holders will get paid for what are now literally billions of noncompensable music downloads.

Government intervention in the market will be limited, because it's a voluntary system.

Broadband technology will get a very significant boost, because the so-called "killer application" of broadband—namely, Internet file-sharing—will be lawful and enabled.

Investment dollars, one might presume, will pour into the newly legitimized system.

Music fans will finally have completely legal access to an essentially unlimited selection of music, whether it's offered from a major label or not.

The distribution bottleneck, as I alluded to earlier, that has limited opportunities for independent artists, will be removed.

And payment will come only from those persons who choose to participate in the system.

I can't promise you, Senator, that all of those things will come to pass. I think the potential that they might warrant at least serious discussion, and, conversely, should not entitle any individual stakeholder to say, "We're simply not coming."

Senator INOUE. Thank you. My time is up.
 Mr. EISGRAU. Thank you, sir.
 The CHAIRMAN. Senator Pryor?

**STATEMENT OF HON. MARK PRYOR,
 U.S. SENATOR FROM ARKANSAS**

Senator PRYOR. Thank you, Mr. Chairman.

Mr. Eisgrau, if I may start with you, just—and I may have missed this, because I had to step out for the vote, and I may have missed what you said in your opening statement, but just give us, if you can, the bottom-line impact that the *Grokster* decision has on your industry.

Mr. EISGRAU. Litigation. The——

Senator PRYOR. Does it create uncertainty for you?

Mr. EISGRAU. It certainly does, sir. The one certain thing is that there will be additional litigation regarding the parties to that specific case. There is much that remains uncertain about the law of secondary liability and how this new inducement test the court articulated will play out.

Senator PRYOR. Do you see that the growth in the industry that you've had in the last several years, which has been fairly phenomenal——

Mr. EISGRAU. Yes, sir.

Senator PRYOR.—has it not? Do you think that growth will be sustained, or do you see steady growth, or what do you see?

Mr. EISGRAU. We certainly do see steady growth. The *Rolling Stone* article I alluded to in my testimony also reported that the current level of peer-to-peer usage would be about nine million uses per month, Senator.

Senator PRYOR. Are you—if you can speak for the industry, is your industry happy with the decision, or not?

Mr. EISGRAU. I'd have to say that, based on the statements of the parties to the case, the public statements that were made, that they were certainly disappointed in the Court's focus on what the court believed to have been established facts in the record. They are hopeful and confident that when this goes back to the District Court, that some of those misunderstandings may be clarified. I think they were also disturbed, as many technologists, the Consumer Electronics Association among them, noted, with the uncertainties in the secondary liability standards that we're now living with that will have to be played out in the courts.

Senator PRYOR. All right. Let me ask about *Grokster* in terms of domestic versus international considerations there, particularly with offshore peer-to-peer companies. What does *Grokster* do with domestic versus offshore?

Mr. EISGRAU. If I understand your question, Senator—please interrupt me if I don't—*Grokster*, itself, is incorporated in Nevis, West Indies. That did not stop them from voluntarily fully participating, quite clearly, all the way to the Supreme Court in this litigation. One other member of Peer-to-Peer United is based in Spain, and the others are absolutely born-and-bred U.S. companies from the State of Oregon, the State of Florida, and the State of New York.

Senator PRYOR. So, you don't see any differentiation depending on what nation they're—

Mr. EISGRAU. Doesn't appear to be, sir. What I can tell you is, there is a big difference between the companies that founded P2P United two years ago and the companies that said, "You know what? We can hide in the shadows. We don't have to deal with anybody. We don't have to try to negotiate licenses with the recording industry, only to have the plug pulled on the deal as a result of a black list." What we do find is that this problem that scholars have referred to as the imminent "Darknet" is a very significant danger. And the continuing attitudes that the members of my association have are, that they not to be dealt with because they're pirates, or worse, we believe, with respect, is highly counter-productive.

Senator PRYOR. Well, just for the whole panel, I'd like to, after the hearing or whenever it's convenient, if you all ever want to talk about the Darknet and some of the issues that he's referred to, I'd enjoy doing that.

Let me ask, if I can, Mr. Kerber, what impact does *Grokster* have on your business, in your industry?

Mr. KERBER. I think what it has done, coming from the financial world, in my background, certainty is a good thing for the financial world. So, what it has done for investment is, it's made a clear path for those venture capitalists, any type of investor—equity investors, hedge funds—that would come in and invest in the potential of a small company that can flourish in the potential growth that digital media offers. It allows that to occur now. I think that from what we can see in the marketplace, just based on our own experience, that what it's enabled and what it has done is, it's made the equity investor, who has a fiduciary responsibility to their investors, to—comfortable with investing in what was a rogue technology for a very long time.

Senator PRYOR. OK. Mr. Heesen, we've been talking about the changes that *Grokster* has brought to all of you. Let me ask you this question. I assume, with the changes that we've all talked about, there could be new business opportunities. Do you see some new business opportunities, or do you see a—what do you see for the future, in light of *Grokster*?

Mr. HEESSEN. Well, I agree that I think there is a bit more certainty. There are some issues regarding secondary liability that we continue to be concerned about. Frankly, if I were going to tell you what technologies are going to come out as a result of *Grokster*, I would not be representing my membership well, because they're the ones who want to be finding those technologies and creating those jobs and finding those good companies out there to invest in. So, all of that is being worked on, frankly, in garages all across the country by entrepreneurs right now, and they're not going to tell me that answer, and they certainly aren't going to tell you, Senator.

Senator PRYOR. OK. If I may, Mr. Bainwol, flip over to you very quickly, because I know we're—the clock is running here. But, as we all know, throughout the course of the music industry, there have been technologies out there, things like cassette tapes and even people pressing unauthorized vinyl copies, et cetera. I know

that, like back in the 1960s and 1970s, you had the basement tapes, you know, from various groups, including Bob Dylan and a bunch of others. But how—as a—in comparison with that type of piracy, you know, where people were copying albums and distributing to friends or sold them, kind of, black market—compare that sort of regime to what we’re looking at with the peer-to-peer. Compare that.

Mr. BAINWOL. Yes, there are two huge differences. One is quality. When you taped off the radio, you had a degradation of quality. Now you can get perfect digital copies. And, two, your ability to share exponentially with millions of people around the world is immediate and automatic. So, that’s the challenge. The nature of the piracy is far more virulent, and the velocity of the piracy is far faster.

I’d like to take a second, if I could, on a point that Mr. Eisgrau raised. We have licensed, happily, lots of legitimate players throughout the digital space, including the peer-to-peer world. Licensing’s not a problem. There are songwriters who have lost their livelihoods—and artists and musicians—not because of that—some of these illegitimate folks in the P2P space have not been licensed. They have lost it precisely because they have set up systems that are predicated on theft. The Supreme Court said the objective is unmistakable.

The fix here is for these companies to say, “We’re going to embrace legitimate commerce. We’re going to go straight. We’re going to convert. And we’re going to shut down our systems and go straight.” That’s the answer.

Senator PRYOR. Mr. Attaway, last question, and that is, pirating movies is a growing phenomenon. We know that. We see that all over the world. Are there any differences in—from your standpoint, in the illegal sharing of music files versus video files? And I guess what I’m asking is, if there is, tell us what they are and tell us whether you think Congress should be involved in that in any way.

Mr. ATTAWAY. Well—

Senator PRYOR. That’s it.

Mr. ATTAWAY. There are no legal differences. Fortunately for the motion picture industry, there are technical differences, in that it takes a much bigger pipe to download a full-length motion picture than it does a musical work. But, either way, it is theft, it is piracy, and it needs to be dealt with. As I said earlier, I think the Supreme Court decision, in *Grokster*, has given us tools to deal with that issue, and I don’t think that there are major things that Congress needs to do right now to help us. If the tools we have turn out to be inadequate, we very well may be back up here asking you to help us deal with this problem.

Senator PRYOR. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Ensign?

**STATEMENT OF HON. JOHN ENSIGN,
U.S. SENATOR FROM NEVADA**

Senator ENSIGN. Thank you, Mr. Chairman. And thank you for holding what I consider to be a very important hearing on a difficult issue, as we’re seeing here at the table. Intellectual property

is one of our biggest exports from America. Intellectual property is very valuable, and I agree with those who think that intellectual property rights need to be protected. Whether you are a recording artist or a motion picture producer or software developer or whatever it is, somebody who has created something—just like somebody who has a patent—must have adequate protection for his or her intellectual property.

Having said that, if we could explore this idea of disruptive technologies—not just with the idea of peer-to-peer, but disruptive technologies from an investing standpoint. From venture capitalist perspective, Mr. Heesen, can you address how tertiary liability could potentially affect investing in disruptive technologies in the future. Such disruptive technologies have the potential to foster huge breakthroughs in healthcare that could save lives. Similarly, disruptive technologies can impact the economy in ways that extend beyond what we're just talking about today.

Mr. HEESSEN. It's an absolute major issue. If the venture-capital firm, itself, and the individuals of that venture-capital firm, can be sued because they invested in a technology that is perfectly legal, but that somebody other than—and that technology move forward, and they invested in that company, and that company was doing perfectly legal things, and somebody else comes along and starts doing illegal things as a result of that new technology, and we are sued because of that, that would shut down our interest in that area. I mean, it's just—it would very quickly dissipate. And venture capitalists are very agile in shutting down companies and moving on to something else. I mean, it's something that we don't like to do, but it's done very quickly. And so—

Senator ENSIGN. Can you—

Mr. HEESSEN.—we would move into another area of technology, absolutely.

Senator ENSIGN. Along those lines, can you give me your thoughts on the distinctions between being a passive investor as a venture capitalist, versus an active investor with management responsibilities or the appearance of management responsibilities.

Mr. HEESSEN. Well, venture capitalists will take an active role in the overall operation of a company, in the respect that they are putting money in, and it's very often substantial amounts of money, and they're saying, you know, "We want to see this company go in this direction over the next 10 years." It's—we don't care about what's happening in a—frankly, in a day-to-day operation, but from a 5- to 10-year perspective, we want to see that company grow to the point where it can be acquired by a larger company or it can go public. And so, anything that comes along that is going to change that outcome, we want to know about, and we're going to take an active role in making sure that the long-range goals of that company remain the way we'd like to see them. We don't always have a majority stake in companies. Most of the time we might have 10 to 15 percent, and there might be a couple of venture-capital firms that, together, may have a majority ownership of a company. But it depends on the technology, actually, very often.

Senator ENSIGN. Mr. Bainwol, I want to be fair to your industry in this regard, and I know you have a different opinion about this.

If you could address the concern that I just raised about disruptive technologies, the idea of things that could tremendously change people's lives for the better, and the fear of venture capitalists that if there is tertiary liability it could shut down the investment necessary to develop disruptive technologies.

Mr. BAINWOL. Right.

Senator ENSIGN. Please discuss this issue from your industry's perspective.

Mr. BAINWOL. Sure. I think the key thing is—I guess there are two points. One is to distinguish technology from conduct. *Grokster* is not about technology. *Grokster*, the decision, itself, is tech neutral. The decision is about conduct. They said the objective of these entrepreneurs was unmistakable, which was basically to perpetrate a fraud, it was to induce second—to induce illegal behavior; and, therefore, they said, they're responsible for it. So, the question here is conduct, not technology.

I'm not an attorney, so I can't speak to questions of tertiary liability. But if you engage in that conduct, then that's probably not tertiary. And that's really the relevant question. When you get involved, and you actively manage and you make choices, and you are responsible for that conduct, then it's not tertiary. And then you're, I think, well within the grasp of this decision.

Senator ENSIGN. Mr. Eisgrau, you wanted to comment?

Mr. EISGRAU. Just a brief word, sir. I don't disagree with Mr. Bainwol's characterization about what the court said about the potential culpability of conduct after further judicial proceedings. I would take respectful issue, however, to say that the uncertainty that is left in the wake of the Supreme Court's recent ruling with respect to exactly what the parameters of secondary and, as you point out, tertiary liability for investors might be, ought to be of some concern. And certainly P2P United and the Electronic Frontier Foundation, with which we co-prepared our testimony, would concur with that of the National Venture Capital Association in flagging this for the Committee and urging it to, kind of, keep a weather eye out for potential disincentives to invest based on the uncertainty of those legal standards.

Senator ENSIGN. To finish out on this, is this something that needs to be clarified in law?

Mr. HEESSEN. At this point, we would say that it's best for—as I said, to have some breathing room here. We would not be run—we do not believe that we should be running to Congress at this point to have any changes made. I think that the courts have a responsibility right now, and we were—take a wait and see attitude at this point.

Mr. EISGRAU. Senator, if I may, again, very briefly, we would agree with that, insofar as the standards of liability are concerned. But both the Venture Capitalist Association and our testimony points out that potentially crushing an astronomical statutory-damage liability may no longer have a place in this now-uncertain environment, and that is something that could be statutorily reformed and, we think, merits discussion both in this committee and other committees of jurisdiction.

Senator ENSIGN. I want to ask Mr. Kerber a question.

Mr. KERBER. Yes, I—if I could respond—

Senator ENSIGN. Hold on. Maybe in your response——

Mr. KERBER. OK.

Senator ENSIGN. Let me get my question in first, because my time is about to run out.

Mr. KERBER. OK. Go ahead.

Senator ENSIGN. In your testimony, you state that the *Grokster* decision clearly illustrates that our system of government is working to achieve the correct balance between protecting the creators of intellectual property and advancing technology. Do you believe that the inducement standard provided in the *Grokster* decision is clear enough to guide your future activities as a peer-to-peer company?

Mr. KERBER. Yes, I do. And I also would add, the protection of the consumer in that statement, also. It's very clear how you get investment. The rules are there. We're a P2P. We're a real peer-to-peer. It's centrally controlled. We can control that and put out on it. We can respect the copyright holder's wants during—through a contractual process. And the way that investors realize that is when they—when we go out and get deals with the record labels, movie studios, and they do their due diligence, the venture capitals do their due diligence, they call, and they find out that, yes, these guys—in our minds, the content owners of these assets, yes, we will allow this to be transferred and distributed and sold on the network.

So, you know, going back to the clarity issue, there is one. It's very, very clear. If you have a contract from a major label, indie label, movie studio, publisher, what they have said is, "We will allow the content to be sold in this manner across our network." So, I'm a little confused by—there's an absolute clear path for an investor to understand what's right and wrong in the process.

Senator ENSIGN. Well, Mr. Chairman, this hearing is very important, because it also illustrates—and this is something Mr. Bainwol talked about—that we have a generation of kids who grew up thinking it's OK to steal music, it's OK to steal movies, it's OK to steal video games, whatever the intellectual property is. And I think that the *Grokster* decision could be a turning point, as far as morality is concerned in this country. The *Grokster* decision may help to teach the next generation to respect private property—the same as it's wrong to break into somebody's home, it's wrong to break into an artist's library and steal their content. I think that is an important lesson to teach the next generation as it matures. I don't know how much we can do about the generation that just grew up and is in its 20s now. But certainly—you know, I've got a 13-year-old at home, and younger, and they are actually talking about it now differently than kids were talking about it even 5 years ago. They're understanding that they need to purchase music and the like if they're going to download it legally. And I think that that's a dramatic change that we need to continue to enforce and look for ways that we can encourage that type of behavior in this country.

And I thank you, again, for holding this hearing.

The CHAIRMAN. Well, the Senator's—you're right, but the real problem that I have—we were informed that—there was a discussion here this last week about the European Commission and what

they're trying to do and bring about a gradual response to—from the providers, themselves, to illegal file-sharing. It doesn't sound to me like there's any motivation here for a mechanism to bring about some standards for the future, as far as these organizations are concerned, some type of body that would come into being by mutual desire to sort of set standards that will look toward copyright protection. Am I wrong? Is there any motivation here in the industry to do something, because of *Grokster*, that will give us a concept of pushing back a little bit and saying, "Look, this is not right, and we're not going to condone it, we're not going to deal with people who do encourage this type of activity"?

Mr. BAKER. If I may, Mr. Chairman, I don't think that a European Commission-style impetus is necessary here. I think we're all in agreement that we don't condone it, and I think that the Court was abundantly clear that one may not induce others to infringe on copyrights. And so, I think that this is being dealt with—

The CHAIRMAN. Well, I'm informed that the commission has taken the position that they want to bring about a situation where the ISPs notify their clients that they're going to be watching to see whether they, in fact, condone illegal activity. Am I wrong?

Mr. BAKER. That—I'll agree with your characterization of what the European Commission said. But, again, here, we've all made abundantly clear to all of our members—and not just our company, but Internet providers, across the board, whether they're independent Internet providers, phone companies, cable companies, whoever—that we don't condone this. But the problem is that you can't take the provider of the pipe and make them a policeman. We transmit literally terabytes of information every hour. It would be absolutely—I mean, it's physically impossible to monitor all of the traffic that crosses our network. I mean, we do monitor—we're able to filter out viruses, we're able to filter out spam, we're able to filter out spyware, things like this, but there's no way, when there's just a music file or something that's just coming across the network, number one, to readily identify what those bits of information are, number two, to know whether a—whether there is a copyright on that, whether somebody's downloading it legally, illegally, et cetera.

The CHAIRMAN. Wait a minute. Do you mean to tell me the provider won't know that—if there's constant illegal activity going on in its system?

Mr. BAKER. That's what I'm saying, Mr. Chairman. Trillions of bits of information every hour transmit across our network, and—

The CHAIRMAN. But—you're telling me they don't know? Is that what you're saying?

Mr. BAKER. I'm saying that, as an Internet provider, we don't know when just these bits of information flow across our servers and routers and off to other carriers and across backbones that—to know what that content is, much less if it is a—if it is, say, a music file, whether that's been paid for by a legal service, or illegal. Now, some products, such as Apple iTunes, for instance, have a different format; and so, are readily identifiable. And so, there's a pretty high level of confidence that those have been paid for. But if it's just something like an mp3 file, it's just a generic format.

There are, again, just by looking at those bits of information, though, you can't tell whether a fee has been paid on that or whether that was pirated.

The CHAIRMAN. Well, I've got to yield to the Senator from California, but one of the reasons that this hearing is being conducted is, we want to, sort of, send a notice, we are going to be watching. We want to know, What are you going to do to follow up on this to take the path the Court seems to think could be taken to give greater protection to this copyrighted material? And I don't hear much, myself, that indicates that there's going to be any attempt to find some ways to set some standards and to do what the Senator from Nevada suggests, to bring into the new generations a concept that we do not condone stealing property. Now, I hope that we're being heard. I do hope we're being heard, because there are people in the Senate who want us to move now, and we're holding a hearing to try to see what is going on in these industries to see what might be done to terminate this illegal activity.

The Senator from California?

**STATEMENT OF HON. BARBARA BOXER,
U.S. SENATOR FROM CALIFORNIA**

Senator BOXER. Thank you, Mr. Chairman.

I want to associate myself with the remarks that you just made. And I just want to take a minute to talk about the way I see the *Grokster* decision. And if I get something wrong, I'd appreciate if any of the members of the panel, our distinguished panel, will let me know if I'm not interpreting it right. And then I have a question of Mr. Eisgrau.

Grokster was a unanimous decision, and that's very rare, that the court's justices, who represent a range of judicial philosophies and personal perspectives come together in agreement. And, to me, it's easy to see why, notwithstanding Mr. Eisgrau's comments—but I have disagreements with Mr. Eisgrau on a number of issues.

Fundamentally, the Court was simply saying that theft is wrong, no matter how you dress it up. And I would agree with Senator Ensign that we do have a generation out there that says, "The best things in life are free, and it's mine." But I think they are learning. Even that generation is beginning to see the light, because of the work of companies like Apple, for example, who's now making money doing something right. They help us understand that property is property. If somebody steals a bike in front of your house, they're a thief, and if they steal your music, they're a thief. And that's just as simple as it gets. And especially theft of intellectual property, which is the strongest commodity that we have. Mr. Chairman, at this point what makes America so great is our intellectual property.

Companies that create a business based on promoting the theft of intellectual property, and advertise their technology for such illegal uses, should be held accountable. And I don't think venture capital should go to them. It's ridiculous. And I appreciate Mr. Heesen's comments, that he doesn't think we should have, legislation at this particular point. That he is not that worried, because venture capitalists don't want to put their money in something that's involved in thievery or that will, in fact, result in pornog-

raphy getting to our children, which is the most despicable thing I've ever seen in my life.

You know what I'm talking about, Mr. Eisgrau. You've seen the problem there. You have kids thinking that they're going to get somebody's music, and they click on a link, and what do they get? They get something horrific that could damage them forever. It's a disgrace. And it has to be stopped.

I sent you a letter, along with a bipartisan group—it was Senators Durbin, Gordon Smith, Feinstein, Lindsey Graham, and John Cornyn. That's the range of Senators around here. And what we basically asked is, "what are you doing to prevent or reduce copyright infringement and illegal access to pornography?" We've written you on more than one occasion. When I say "you," let me say exactly who it was—the letter was to the owner of Grokster, the president of BearShare, the president of eDonkey 2000—I don't like that name, as a Democrat—president, Lime Wire, president StreamCast Network's Peer-to-Peer United. And it was delivered to Ms. Nicki Hemming, CEO, Sharman Networks. We don't have an answer from you. We're very concerned about this.

Now, the court distinguished between situations where a company produces a technology that can be used to violate copyright laws but has other legitimate uses and a situation like Grokster's, where a company actively encourages infringement of copyright through the use of its technology. It's kind of like the intended use and the side-label use. What is the intended use? That's what the Court was getting at.

And it's important to remember that the Court merely clarified the legal situation. The Court didn't find Grokster or anyone else liable. The case was remanded for further consideration by a lower court.

A true understanding of the issue will not be known until the lower courts have had time to interpret and apply the decision in different cases. In a year or so, the content industry will have a better idea of whether the ruling has decreased illegal file-sharing, and the technology industry will be able to assess whether innovation and funding has been impacted.

So, it seems to me this next year is key, but, I agree with the Chairman. In a year's time, if you don't move to protect copyright, if you don't move to protect our children, it's not going to sit well, regardless of what the court has said.

I think the whole world is watching now, after the *Grokster* decision, and, in that post-*Grokster* world, I hope both industries flourish. Look, for me, it's like choosing between children. In my state, I've got Hollywood, I've got Silicon Valley. This is a nightmare for me. I've got the venture capitalists. I've got everybody.

So, what do I want? I want everybody to come out of this in good shape. But there is a right and wrong here. That would be the end of my comments.

But I do have a question, to Mr. Eisgrau. Can you tell me what steps you're taking to respond to my letter, the letter of the six of us? In light of the case, how can companies such as BearShare and LimeWire continue to promote infringement? Shouldn't they take active steps now to stop infringement, even though the Court, kind

of, said, "Well, figure it out." Shouldn't they be moving now? And, if they are, what are they doing?

Mr. EISGRAU. Thank you, Senator. There are a number of parts to that question. Let me see if I may respond to them in turn.

First, with regard to your invitation to make a minor point with respect to the characterization of the *Grokster* opinion, itself, the Court did not find—it's my understanding—that if a technology does not have—that it must demonstrate legitimate use to a broadscale degree. In other words, it left the initial Sony fundamental premise intact. What I can tell you, Senator, with respect to the technologies of P2P United—which do not include, regrettably, LimeWare and Sharman, so I can't speak for them—on a number of the issues you've raised, starting with pornography, first of all, the individuals, many of whom are parents and grandparents, that run the companies that are members of P2P United, believe that the people who prey on our children and who perpetrate child pornography belong in prison, or worse. And that's why we've been cooperating with law enforcement, to an extensive degree, to try to deal with that problem. We mounted a parent-to-parent resource center on our own website, which is linked to from every website of the members, which provides resources, including how to report suspected child pornography, including links to outside resources so that parents and others may find out what it is, a number of additional resources, as well. We don't support that. We do not run computers that house child pornography. We do not run computer networks that have servers that, for that matter, house copyrighted information, Senator.

So, the question, if I understood it correctly, that you were posing is—in the sense of, What are we doing?—is, How might we modify the technology—which, as I said earlier, perhaps before you arrived, is a neutral pipe, in the same way the Internet and the phone system is a neutral pipe—how might we modify that technology to affect what individuals do to use it is, frankly—we cannot, and we are not. We believe that the solution here lies—particularly with respect to copyrighted information—in, perhaps, the kind of system of collective voluntary licensing that we were discussing earlier.

And, if I may take just a half-minute, literally, to flesh out what that means, in practical terms, it's a little, perhaps, unbelievable, at first blush, to realize that what we are proposing is a system that artists and copyright owners would elect to participate in. That would mean that it would—they were saying it's OK for their material to be accessed by individuals without their advance permission, as long as those individuals pay into a collective. That would mean that what is now unlawful downloading activity on the part of these individuals would, under such a system, be lawful. In the same way that it was illegal to take a drink during Prohibition, it would now become legal for that download to occur, because a royalty system of compensation would be in place, administered by something like ASCAP, and measured by companies that the recording industry, itself, now uses, similar to Nielsen and Arbitron, to determine what is being downloaded.

Senator BOXER. Sorry—

Mr. EISGRAU. Yes, ma'am.

Senator BOXER.—you lost me somewhere. I'm sorry. You lost me.
[Laughter.]

Mr. EISGRAU. I apologize.

Senator BOXER. I want to follow what you—

Mr. EISGRAU. My point, Senator, is, first, with respect to copyright infringement, there are ways to rationalize this that do not involve modifying the technology so that the neutral pipe is somehow outfitted with a system that allows oversight of content. We would share many of the same difficulties in looking—in fact, more so than content than the gentleman from EarthLink described earlier.

Senator BOXER. OK.

Mr. EISGRAU. With respect to pornography—

Senator BOXER. Would you—

Mr. EISGRAU.—we're part of the solution, not part of the problem. And we agree with you that it is a giant problem. But as the General Accounting Office pointed out, it's an Internet problem, not just a peer-to-peer problem, as well.

Senator BOXER. Well, everybody's got to fix it. This is damaging, number one. So, let's not say, "It's not mine." Yes, it's part mine, it's part theirs, it's part—you know what? It's over, here, with this. This has got to end. I don't care that you don't like pornography. I don't like—I believe that. You're a dad. I'm a grandmother. This is good. But, you know what? We're here talking about the public. There's a lot of people who make cars who are wonderful, and, you know, they don't want to be in a dangerous car, but maybe they're not doing their best. And that's why we have standards. So, let's just—this isn't about us, personally. When I talk to you, I don't mean it personally.

Mr. EISGRAU. Not taken that way, Senator. Thank you.

Senator BOXER. But just answer this question. Would you agree with this, that several developments have taken place which highlight the technological capacity to filter? Would you agree that that has happened?

The CHAIRMAN. We have to wind this up, Senator.

Senator BOXER. I'll wind it up.

Well, do you agree with that?

Mr. EISGRAU. No. And if I may drop a very—

Senator BOXER. OK. Well, then if—

Mr. EISGRAU.—brief footnote, Senator—

Senator BOXER.—you don't agree with it—

Mr. EISGRAU.—it's important.

Senator BOXER. I have asked you to look at—World Media, Mashboxx, and P2P Revolution which have announced licensed legitimate direct-to-consumer P2P distribution services that will filter for unauthorized works. My time is up. My Chairman has been patient. I think we're moving along, and I sense a resistance here. Maybe I'm missing it, but that's what I sense.

The CHAIRMAN. Senator Inouye?

Senator INOUE. Mr. Chairman, I'll try to follow up with you and Senator Boxer.

In the decision, I believe the Supreme Court made it rather clear that the P2P activity occurring online is illegal and amounts to theft, much of it.

Mr. EISGRAU. Yes, sir.

Senator INOUE. Now, you have responded to Senator Boxer that you were suggesting a summit meeting to resolve this question. My question is, what have you done with your clients to discourage them or to prevent your clients from engaging further in illegal activity?

Mr. EISGRAU. Thank you, Senator.

The illegal activity that might be applicable in this case, according to the Supreme Court, would be activity by the software developer to encourage users of that software to use it in order to infringe copyright. That's the inducement language in the Supreme Court's opinion, sir. The members of P2P United do not now—and since I have been involved with them, I would respectfully submit, do not induce anybody to commit copyright infringement.

With respect to StreamCast, the makers of Morpheus and Grokster, the two pieces of software at issue with the Supreme Court's case, the Senator from California is correct, that will be going back to the trial level to see whether, years ago, an earlier version of their software was marketed under past practices that might subject them to liability under the Supreme Court's new test. But the bottom line, Senator, despite what you may hear from elsewhere, we do not induce, we do not encourage or condone, copyright infringement. Indeed, if you go to our website, there is an unmistakable, very large "C" in a circle, with a very stern copyright warning, smack in the middle of the page, sir.

With respect to whether we can or—modify, technologically, the software in order to somehow filter copyrighted material, the systems that Senator Boxer just alluded to, and the gentleman from World Media produces, are essentially closed systems, as just described here before you. They are not traditional open peer-to-peer architecture. That's a significant distinction. There would be very serious social, scientific, educational, all kinds of ramifications if, in fact, Congress were to require or suggest that only so-called "closed" peer-to-peer operating systems were now lawful.

Mr. ATTAWAY. Senator Inouye, we agree with Senator Boxer, and are just as frustrated, that it's not enough simply to say that infringement or pornography is bad. There has to be something done about it. And that's one of the good things about the Supreme Court decision. The Supreme Court looked at a number of factors. One of them was the fact that the defendants in this case took no action to prevent the massive infringing activity that was taking place. We hope that, as a result of the Supreme Court decision, there will be incentives for all players on the Internet to not just condemn pornography and infringement, but to do something about it. And we look forward to that happening.

Mr. EISGRAU. Senator, may I call your attention to footnote—

Mr. BAINWOL. I think it's my turn, Adam, if I may. And let me just add a precision to your comments. Adam's laid out a very elaborate, kind of, scheme to dodge the fundamental reality that his companies have not accepted what's gone on here. These companies have the ability to shut this illegal-taking down right now. They're choosing not to. Let's be clear. He then goes to this notion of this, kind of, fancy collective, which sounds good, but it's less filling. It doesn't work. I mean, what he's really saying, at the end,

to make it work, he's talking about a compulsory license. He's saying, "Congress, pass a compulsory license, and let's go ahead and take revenue from a mandatory tax on ISPs, and let's take it and give it to music rights-holders." But—oh, but there's a problem. What do you do about movies and software and games? You've talked about the size of the intellectual property segment of this economy. There is no real practical way to follow that suggestion. That's a dodge. It is a failure to accept responsibility for the fundamental fact that his companies have a business model predicated on theft. They need to deal with that fundamental question.

Mr. EISGRAU. If I may, Senator Inouye, you've been affirmatively misled in two respects that are important to clarify.

First, as emphasized in my testimony, a voluntary collective licensing system—there is substantial scholarship on this—a voluntary collective licensing system is inherently different than a compulsory license. The principal difference being, one requires legislation, one requires simply having a series of good-faith discussions to see if we can get there. We are not, absolutely, for the record, calling for legislation or a compulsory license of the kind to which Mr. Bainwol responded.

Second, the claim that there is a technological magic bullet that a peer-to-peer software developer that makes its product available to the public can engage in that creates a watertight copyright protection system is simply false, and I would urge you and this committee not to take the word of any advocate for that, but, rather, convene technical experts who can tell you the truth.

Third and finally, very quickly, footnote 12 of the Supreme Court's opinion is important to emphasize. What it says—and it's brief—is as follows: In the absence of other evidence of intent, a court would be unable to find contributory infringement liability merely based on a failure to take affirmative steps to prevent infringement if the device was otherwise capable of substantial non-infringing use. Such a holding would tread too close to the *Sony* safe harbor.

The standard for liability in this instance, although it's been suggested otherwise at this panel, is not that Company X fails to install a filter that meets the approval of an entertainment company. If that were the standard, we would seriously threaten innovation and capital investment. And that ought to be of enormous concern to this committee, sir.

Senator INOUE. Obviously, I know very little about technology, but Mr. Bainwol said that you could stop it right now. Is that realistic?

Mr. EISGRAU. No, sir. That is not. That is not. And Mr. Goldring, the entertainment lawyer in the editorial in the record, says as much.

Senator INOUE. Mr. Bainwol?

The CHAIRMAN. Wait, wait, wait. Now, let's take our time here, please.

Are you finished, sir?

Well, we've got to wind this up sometime, because we've been in session here now 5 hours, almost 6 hours, in this Committee today alone.

I do want to say this. Senator Boxer and I rarely agree, but when we do I think people ought to listen a little bit.

[Laughter.]

The CHAIRMAN. We're going to have a hearing this fall about the pornography aspect of this. We're talking right now about the business models of trying to contain illegal activity. But we've got—we're going to get specific about this pornography over the Internet. People tell me we can't do anything about it. I don't believe that. So, we'll see that this fall.

But we are also told that, on peer-to-peer, for promotional activities, the provider puts out a display and tells people what they can see if they watch it. And there are ways of demonstrating to the public why they should watch—what they should use, a portion of the Internet, as opposed to another one. I do think that—if that's the case, that your Supreme Court footnote has been met, because there's affirmative action on the part of the provider to tell people to look at something, and, if they provide a list, and on that list are some items that they know are not protected—that ought to be protected, and they're not, they're participating in this activity.

Now, I hope—again, I'm back to the point where I said, I hope you're listening. Senator Boxer has just provided me a good example of the comments I've gotten in the room about, "Why don't you do something, Mr. Chairman? Why don't you follow up on this Supreme Court case?" Well, all we held this hearing for was to say—to listen to you to see if there is any indication that the industry is going to do that. And I, again, say to you, the difference between this—I hope that you do it, because, if you don't do it, I'm going to move over and be with Senator Boxer on this. And I think the whole committee will. We've got to find some way to meet this concept of protecting our intellectual property. We can hardly accuse the people abroad of stealing our intellectual property if we can't protect it at home.

Now, that's the message we've got to give you. And, unfortunately, I have to adjourn this hearing right now. Thank you very much.

[Whereupon, at 4:40 p.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF MARTY LAFFERTY, CEO,
DISTRIBUTED COMPUTING INDUSTRY ASSOCIATION (DCIA)

Dear Chairman Stevens and Ranking Member Inouye:

Thank you for holding this important and timely hearing on issues related to *MGM v. Grokster* and the appropriate balance between copyright protection and technology innovation. We greatly appreciate your leadership and that of your Commerce Committee colleagues. We are grateful for this opportunity to share the Distributed Computing Industry Association's (www.DCIA.info) perspective on this critical industry and consumer issue.

Long-Term Benefits of the Supreme Court Ruling

The DCIA welcomed the Supreme Court's refusal to rework the Betamax decision, and remains optimistic that the grounds for secondary liability it defined will prove in the fullness of time to be fair and workable.

As the case works its way back through the lower courts, we anticipate clarification of the rules of engagement between content providers and technology suppliers in the digital realm generally, and with respect to peer-to-peer (P2P) file sharing in particular.

We are confident that the Court's decision in the *MGM v. Grokster* case will ultimately lead to the continued expansion of our industry.

We should clarify that our vision for that expansion does not center on filtering copyrighted works out of the P2P environment, but rather on deploying commercial and technical solutions, which the vast majority of rights holders will find attractive, for secure licensed and profitable redistribution of such works via file sharing.

Given the pace of broadband deployment and Internet-based software development, it is far preferable to focus on achieving the full potential of highly efficient P2P technologies for revenue generation—rather than on shortchanging that potential.

In the file-sharing environment that we are working to establish, rights holders will have the digital rights management (DRM) tools and support services to manage key aspects of every transaction—and to monetize them through such means as advertising support, sponsorships, cross promotion, packaging, subscriptions, and a la carte sales—whether their works are initially entered into redistribution by themselves or by others—including consumers.

We have already urged all affected parties to focus on deploying new business models for content distribution that are non-infringing and expand the marketplace for digital content, and not to pursue legislative intervention at this time, which would only be counter-productive. The private sector, with added clarity that will result from pending lower court outcomes, should manage the process from here, until we reach a later stage as described below.

The *MGM v. Grokster* ruling provides impetus for the P2P distribution channel to grow and flourish. P2P DRM technologies and micro-payment services have been proven with computer games, software, and independent music and films. Major labels and studios can avail themselves of these tools to develop marketplace solutions—starting today.

To quote Justice Breyer:

“The record reveals a significant future market for non-infringing uses of Grokster-type peer-to-peer software. Such software permits the exchange of any sort of digital file—whether that file does, or does not, contain copyrighted material . . .

Such legitimate non-infringing uses are coming to include the swapping of: research information (the initial purpose of many peer-to-peer networks); public domain films (*e.g.*, those owned by the Prelinger Archives); historical recordings and digital educational materials (*e.g.*, those stored on the Internet Archive); digital photos (OurPictures, for example, is starting a P2P photo-swapping serv-

ice); ‘shareware’ and ‘freeware’ (*e.g.*, Linux and certain Windows software); secure licensed music and movie files (INTENT MediaWorks, for example, protects licensed content sent across P2P networks); news broadcasts past and present (the BBC Creative Archive lets users “rip, mix and share the BBC”); user-created audio and video files (including “podcasts” that may be distributed through P2P software); and all manner of free “open content” works collected by Creative Commons (one can search for Creative Commons material on StreamCast) . . .

I can find nothing in the record that suggests that this course of events will not continue to flow naturally as a consequence of the character of the software taken together with the foreseeable development of the Internet and of information technology. There may be other now-unforeseen non-infringing uses that develop for peer-to-peer software, just as the home-video rental industry (unmentioned in Sony) developed for the VCR.”

We hope the Court’s decision will lead to a shift away from conflict and toward commerce, and we encourage everyone to come to the table and develop new business partnerships. The MPAA and RIAA and their powerful members control ninety percent (90%) of popular entertainment content distribution and can now move forward to license responsible P2P companies using this highly efficient and extremely popular channel for the distribution of their copyrighted works to create new markets and revenue opportunities.

P2P file-sharing technologies are part of the larger movement to an increasingly distributed computing environment. As the Court affirmed, this kind of technological progress is inevitable—embracing it to harness its capabilities will prove to be much more gainful than resisting or trying to stop it.

While it is regrettable that the earliest outcome of the Supreme Court’s ruling likely will be additional backward-looking litigation—and even more unfortunate because parties on both sides over time have implemented changes in business practices paving the way for them to work together—we can now also engage in more constructive activities without the uncertainty as to what the Court’s decision will be.

Specifically, the DCIA has embarked on three areas of activity comprising development of: (1) a comprehensive best practices regime based on analysis of the Supreme Court opinion and concurrences; (2) a promotional program highlighting licensed content P2P distribution, appropriate software usage, and protection of children online; and (3) a technology solution initiative that emphasizes a combination of “offensive” tactics (*e.g.*, placement of DRM-protected and other licensed files at top of search results) with “defensive” tactics (*e.g.*, conversion of unauthorized files into licensed quality-controlled versions) that have long-term viability.

While some either cynically or naively propose forcing a migration to provisional closed P2P systems and/or continuing to use lawsuits and smear campaigns to express their opposition to real industry progress, it is right at this moment that we demonstrate our commitment to more positive alternatives.

Trying to drive global Internet users to abandon an ever-increasing abundance of open and inter-operable software applications, which facilitate the instantaneous transfer of files with greater and greater efficiency, ignores marketplace realities, and particularly the effects of an ongoing evolution to low-cost open-source program development.

It makes much more sense to put resources into projects concentrating on the third area of activity outlined above, which are distinguished by an emphasis on equipping individual files to carry the means of their protection and monetization with them as they are transported over public networks.

DCIA Members have relevant experience that can be applied in this initiative along with their expertise and capabilities to benefit not only legitimate business interests, but also consumers.

It is clear that certain of our industry’s opponents are trying to leverage the courts and Congress to perpetuate entrenched but no longer optimal business models, temporarily curtail or slow down technological advances, and maintain hegemony of now outdated processes for content exploitation.

Our opponents blame others for their own failures to exercise responsible stewardship in protecting copyrights during a more than two-decades-long conversion to digital content origination and distribution. They seek to compel third parties to pay for solutions to problems arising from their own neglect, and buttress their campaign with intimidation. Instead, we need to come together to complete the tasks that must be done for all affected parties to move ahead.

It is important that those who oppose the growth of the distributed computing industry realize that our determination to continue developing P2P technologies for

legitimate purposes is greater than their determination to restrain, obstruct, or suppress these efforts.

Short-Term Concerns About the Ruling

The divisiveness of what has become a protracted conflict between major entertainment conglomerates and current-generation P2P software distributors has unfortunately been exacerbated by the Supreme Court's decision—indeed the immediate result of the high Court's ruling will be renewed litigation among these parties in the lower courts. More disturbingly, consumer lawsuits by music and movie industry interests are also continuing unabated. None of the entertainment industry's prospective new sanctioned P2P applications has yet to launch, and reportedly, P2P copyright infringement levels continue steadily to increase.

To make matters worse, the business models and technology solutions put forth by the DCIA's now more than fifty (50) Member companies and other qualified independent entities, to provide copyright protection while also promoting continued technology innovation, have not yet received the major entertainment sector support or the media attention that they merit. This despite the fact that they are squarely grounded in marketplace realities rather than wishful thinking, are focused on commercial development that will benefit all affected parties rather than just certain entrenched interests, and are gaining traction as clearly demonstrated by their promising initial consumer acceptance.

The DCIA firmly believes that P2P copyright infringement can not only be dramatically reduced, but that P2P 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. Service-and-support firms need to be allowed to demonstrate that they can provide adequate safeguards through such techniques as P2P DRM and micro-payment solutions, 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.

Fully addressing the P2P copyright infringement problem for the long-run will require a coordinated, multi-faceted approach that includes content and technology sector collaboration, cross-industry self-regulation, and targeted enforcement. But first, appropriate activities for companies and consumers alike to use P2P in authorized ways for redistribution of copyrighted works need to be established. Users need clearly to be shown appropriate ways to utilize P2P to access and share popular entertainment content. It should be deemed unacceptable, for example, that not a single major label track is yet available in a licensed format in today's P2P environment.

Our view is that it is essential for any proposed solution's viability that it be agnostic in terms of working with current and foreseeable P2P applications, including open source clients and swarming transfer protocols. To be fully effective, it 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 unsecured files of such works by third parties including end-users—and their continued prevention from being redistributed in unauthorized form.

Not to oversimplify this matter, but it seems to us that two fundamental tasks with respect to securely redistributing copyrighted works via P2P can be defined as:

(A) To apply P2P DRM to a file (permitting rights-holder[s] to set price, usage terms, etc.), then create multiple variations of the secured licensed version of the file (supporting robust viral redistribution), and finally seed these initial authorized copies into the file-sharing environment in such a way that they will appear at the top of search results on major P2P software programs (using algorithms unique to each protocol) and other search engines; and

(B) To support a system that essentially mirrors the decentralized architecture of P2P applications, extended to include torrent technologies which break files into smaller pieces, 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 P2P traffic.

To date, DCIA Members have developed and deployed solutions needed for task “A” for major P2P software programs including BearShare, eDonkey, Grokster, Kazaa, Morpheus, TrustyFiles, etc. as well as some search engines and websites, despite being hampered by a very limited amount of test content. Examples of companies actively engaged in this—and their solutions, include Altnet—TopSearch; INTENT MediaWorks—myPeer; Shared Media Licensing—Weed; Trymedia Systems—ActiveMark; and Unity Tunes—Unified DRIV. P2P DRM, e-commerce, payment services, and related solutions providers now include an impressive roster of highly qualified firms such as Clickshare, Digital Containers, Digital Rivers, Javien, KlikVU, P2P Cash, Predixis, Relatable, RightsLine, Softwrap, SVC Financial, and Telcordia.

Their models work well mechanically and these companies are poised for enormous growth as the P2P channel matures. In terms of sales volume, which is obviously the more important issue, it is too early to draw conclusions, however, and results-to-date are skewed by not yet having licenses for major label or studio content and not yet having “B” deployed. New solutions providers are now proposing credible approaches to accomplish “B,” which augur especially well for P2P’s future. With these in place, delivery of licensed digital media content, such as through methodologies developed by Unity Tunes, will evolve into a secure user-friendly model for super-distribution by means of most P2P networks. More than anything, the private sector needs time and encouragement for “B” to be adopted and implemented, and for “A” to be fully developed with the participation of major entertainment rights holders.

In terms of business models and technology support to realize them, DCIA Members are committed to providing the best solutions possible, and engaging on every level to find new and better commercial and technical means to secure and promote licensed content so that it will be possible for every P2P transaction to be monetized with terms and conditions established by rights holders, whether the subject content is initially entered into redistribution by rights holders or by consumers.

The distributed computing industry is actively exploring innovative business models for monetizing copyrighted works in the file-sharing marketplace through advertising support, sponsorships, cross promotion, packaging, subscriptions, and a la carte sales. The industry is building better DRM and payment solutions every day, and is investing in research and development to open the door to greater innovation. We acknowledge the need for solutions that are more user-friendly, transparent, and supportive of fair-use provisions expected by consumers. But most of all what has been missing has been major label and studio involvement as content licensors.

While DCIA Members and others have made significant advances in commercially developing P2P, we also recognize there is still much work to be done beyond attracting the major labels and studios. But these efforts are not the only answers. Effective and complementary self-regulation efforts by the content and technology industries are crucial.

Industry Self-Regulatory Efforts

Specifically, we advocate the establishment of independently coordinated authorities around the globe to help establish P2P file-sharing best practices, and then to serve as an ongoing resource for industry participant certification and dispute resolution. In short, these authorities should provide mechanisms for registering copyrighted works, supporting inter-operability of DRM and payment service solutions, plus monitoring and reporting progress to participants in reducing instances of copyright infringement as a percentage of the universe of P2P transactions. Of course, any technology approved for adoption should be based on open standards and developed with broad input from the affected industries.

As a preliminary step toward achieving this objective, interested parties are now invited to join the *MGM v. Grokster* Response Working Group (MGRWG), which the DCIA established within weeks of the Supreme Court ruling.

We are especially interested in recruiting additional content rights holders, peer-to-peer (P2P) software distributors, and delivery solutions providers.

The principal goal of MGRWG is to recommend a set of best practices for the distribution of P2P software with the object of promoting its use in ways that do not infringe copyright through affirmative steps taken to foster non-infringement.

Our purposes are to enhance and not diminish benefits in security, cost, and efficiency of P2P software for storing and transmitting electronic files, and to encourage further commercial development of beneficial distributed computing technologies. We intend for end-users to be able to prominently employ ad hoc P2P networks for sharing copyrighted music and video files—with proper authorization.

The proposed structure for defining these best practices, subject to full discussion by MGRWG, will have four parts: (1) Advertising Guidelines; (2) Protection Mechanisms; (3) Business Models; and (4) Tracking Studies.

Questions to be answered by MGRWG include:

- What kinds of consumer communications are recommended to promote non-infringing usage of P2P software;
- What types of P2P digital rights management (DRM) solutions are recommended so that each transaction of a copyrighted work's P2P redistribution can take place on terms-and-conditions determined by its rights holder(s);
- What revenue sharing opportunities are recommended for content rights holders to fully exploit the possibilities of P2P for licensed content redistribution (*e.g.*, advertising support, sponsorships, cross promotion, packaging, subscriptions, a la carte sales, etc.) plus what kinds of disclosures, if any, are recommended for non-copyrighted-content related P2P revenue generation (*e.g.*, behavioral marketing, VoIP services, paid search, travel applications, collaborative research, blogging, etc.); and
- What industry-wide measurements using such methods as test-cell extrapolation are recommended to track growth trends of authorized copyrighted works transactions as a percentage of all P2P transactions, as well as other key metrics.

Copyright holders should expect that a balance will be struck between their legitimate demands for effective—not merely symbolic—protection of their statutory monopoly, and the rights of P2P software distributors and others to freely engage in substantially unrelated areas of commerce.

Users should be able to continue to search for, retrieve, and store files without involvement of P2P application providers, who should not be expected to monitor or control use of their software with respect to actual knowledge of specific content transactions. Involvement of other members of the distribution chain, however, should provide the requisite controls to enable secure P2P dissemination of registered works globally.

Decentralized P2P software applications should not be expected to reveal which files are being copied and when, but rather related technology solutions should be supported for affiliated third parties to equip individual files to accomplish this as they are redistributed across public networks using P2P protocols. Filtering copyrighted material out of P2P users' downloads or otherwise impeding redistribution by such methods as blocking usage should not be advocated as impositions on P2P software suppliers. Advanced alternatives will more effectively accomplish the underlying goals that previously have led some to suggest these approaches. JLW

Distributors of P2P programs should be able to clearly voice the objective that recipients use their applications to download licensed copyrighted works, and take steps to encourage them to do so, because the file-sharing environment supports secure redistribution. These and other P2P content-reselling entities should be able to competitively market their offerings to prospective users.

P2P distributors should be able to advertise and instruct consumers on how to engage in authorized usage of their software to download and redistribute licensed copyrighted works and to recommend and directly encourage such usage. They should be able to overtly and aggressively take steps to respond to consumer demand for online access to copyrighted material through highly efficient and very popular P2P software.

As with other DCIA-sponsored working groups, participation in MGRWG is voluntary and open to DCIA Members and qualified non-members. Confidentiality of MGRWG participation will be maintained unless express written authorization for disclosure is given by an individual company in advance. Once the work product, in this case, an outline of best practices, is completed and publicized by MGRWG, adoption and compliance with its recommendations, whether in full or in part, will be a separate voluntary action to be independently decided upon by MGRWG participants (and others) individually.

As the step beyond MGRWG, the DCIA would be willing to serve as coordinator of a multi-industry group constituted with broad relevant multi-industry representation, working in consultation with the Federal Trade Commission (FTC) to help codify best practices.

But in order for self-regulation, business model exploration, and technology development efforts to be successful, ultimately they may well need to be supported by strong Federal legislation to prohibit unacceptable practices and empower consumers without threatening the vitality of legitimate P2P usage.

Ultimate Role for the Federal Government

It is our view 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, in this case primarily content rights holders and P2P software providers, but also closely related telecommunications and technology firms, once traction for a particular solution(s) has clearly been established.

Global decentralization of the Internet has reached the point that it would be virtually impossible to stop the proliferation of P2P file-sharing technology or prevent its continuing evolution to higher levels of efficiency.

The channel has already been proven to be a highly efficient medium for marketing copyrighted works. 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.

The key issue that has perpetuated copyright infringement by means of P2P software continues to be a collusive refusal-to-deal by a handful of large, multi-national, very profitable entertainment rights aggregators, who by their own admission control more than ninety percent (90%) of pop-culture content.

If this continues, what may ultimately be called for is an injunction against "intentional withholding of licensed content from a distribution channel that happens not to be fully controlled by major rights holders."

Copyright infringement is the natural and inevitable by-product of the failure to take necessary steps to protect content from unauthorized duplication and distribution in the digital realm, and then to refuse to license it to willing distributors with proven solutions to problems certain rights holders essentially have created for themselves.

This argument carries through to the fact that these large entertainment copyright aggregators knowingly continue to distribute unprotected CDs and DVDs by the millions, with their only tactics to respond to the massive adoption by consumers of file-sharing technologies being to sue hundreds of users per month for alleged acts of infringement and to sue small P2P software distributors. They themselves are the ones in fact driving consumers to become distributors of infringing copies by not licensing a single music track or video under their control for authorized distribution by means of currently distributed P2P software, as well as failing to take reasonable technical precautions to prevent the free and facile replication and redistribution of their works.

It would seem, in these circumstances, that responsible behavior by the major rights holders would be to follow the example of more progressive independents and license their content for the P2P distribution channel, now that the success of such efforts has been demonstrated.

The true problem in the context of P2P software, where program developers and distributors and solutions providers have sought to negotiate with major rights holders, is that they have been met with a refusal to do business or to even engage in technical tests or market trials.

Despite this, these innovative software companies and solutions providers have succeeded in "competing with free" by licensing and successfully facilitating the marketing of lesser known, less popular entertainment content offered by an increasing number of small independents.

This condition has scrambled the venerable structure of copyright-based businesses. There is a growing need to bring the major rights holders to the table with such willing intermediaries, rather than allowing their litigation against consumers and small P2P developers to continue.

To achieve a more comprehensive solution, Congress may eventually want to consider legislative approaches.

Specifically, Federal legislation should create incentives for P2P distribution channel participants to adopt best practices. One way to encourage companies to adopt best practices is to provide a "safe harbor" for those who are members of an FTC-approved self-regulatory organization. Under this approach, safe harbor participants would be entitled to avoid the burden of additional requirements, based upon their compliance with specific guidelines.

Thus, Federal legislation should identify the basic components that industry guidelines must address, but permit the industry to take the lead in developing the specific guidelines within these parameters.

Here is an outline of what can tentatively be called The Peer-to-Peer Distribution of Copyrighted Works Development Act of 2006:

First Provision: Copyright owners and rights holders, who desire to monetize their copyrighted works by means of digital distribution over discovery and transport pro-

ocols, shall register digital files of such works, in a manner that permits their efficient identification during Internet transport, with the Copyright Office, which shall stipulate the technical specifications for such file identification, as may be reasonably updated from time-to-time.

Second Provision: Owners and operators of broadband ISP services and computer hardware and software manufacturers and distributors, shall cause to be deployed, within twelve (12) months of enactment of this bill into law, and to maintain, systems to accurately track the delivery of files identified in Provision I to individual consumers, in a way that will ensure timely billing for registered copyrighted works by means of distribution via transport protocols designed to discover and deliver digital assets.

Third Provision: Copyright holders in Provision I and technology and telecommunications providers in Provision II shall be entitled to establish pricing and revenue-sharing through private negotiations, to recover their costs for registering, tracking, billing, collecting, etc. and to earn a profit, provided that prices charged to consumers for copyrighted works through distribution via transport protocols are competitive with alternative distribution channels for such works.

Please do not interpret this proposal as a recommendation for compulsory licensing or a derivative of that type of regime. Rights holders would be able to voluntarily license their content or to withhold it, to set rates and to determine usage parameters, and otherwise to exert control over their copyrighted works, just as they do in other distribution channels.

As a strong proponent of the still nascent distributed computing industry, the DCIA is committed to using its resources to help address the P2P copyright infringement problem from every perspective: business models, technology solutions, self-regulation, legislation, and enforcement. We have started to see progress on all fronts, but much more work clearly needs to be done.

We pledge our support to your ongoing legislative efforts, and look forward to sharing our proposals and working with others toward viable solutions. The DCIA offers whatever assistance this Committee would need with respect to such efforts.

