



The Role of Music Licensing In a Digital Age*

Patrick Ross, Moderator
Christian Castle
Mitch Glazier
Lee Knife
Michael Petricone**

Patrick Ross, Senior Fellow and Vice President of Communications & External Affairs, The Progress & Freedom Foundation: Good afternoon everybody. My name is Patrick Ross, and I would like to welcome you on behalf of all of my colleagues at The Progress & Freedom Foundation and IPCentral to our latest congressional seminar titled, "The Role of Music Licensing in a Digital Age."

Now that's a pretty broad topic. One interesting avenue to explore might be to what extent we should even have licenses and particular compulsory licenses. Do they prevent reasonable market transactions? Do the reduced transaction costs offset the dilution of intellectual property rights for artists?

As interesting as that discussion might be, the reality is that licensing has been a part of the music industry for a century, and these licenses aren't going anywhere. Given this reality, a more pertinent set of questions might be: Are current licensing regimes balanced across content, services, and technologies? How are the licensing regimes responding to new disruptive technologies? What can Congress do to ensure balance in licensing and create an environment that invites new technologies while also appropriately rewarding artists?

That's where I anticipate our discussion will go today. Currently, there is legislation in both the House and the Senate that addresses some of these questions. It's known as the PERFORM Act. Now, don't ask me what PERFORM stands for. It's another one of these artful, yet tortured, acronyms that's spreading across Capitol Hill like kudzu.

I personally have proposed legislation that would ban such cute nicknames. I call the legislation the End of Needless Over-the-Top Unnecessarily Gratuitous Handles Act or in short, the ENOUGH Act.

Now, no one has introduced the ENOUGH Act, but the PERFORM Act has been

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** Speaker biographies are available at the end of this transcript.

introduced in the Senate by Dianne Feinstein and Lindsay Graham along with Joe Biden and Majority Leader Bill Frist, and also in the House by Howard Berman and Mary Bono.

What would the PERFORM Act do? Well, that seems to vary depending on who you talk with. Rather than rely on my interpretation, I'd prefer we hear from our expert panelists.

I'll attempt a brief and overly generalistic summary. The PERFORM Act aims to harmonize rates set for various digital music licenses under one standard based on a fair market value. It requires users of a digital government license to provide reasonably available and economically feasible technology to prevent music theft and attempts to distinguish between the performance license and a distribution license stating that a recording device that has TiVo-like characteristics, such as recording by time or program, does not require distribution license. But being able to say, "Record every one of Led Zeppelin's tunes," would.

That last point has gotten most of the press attention with this bill. The Senate hearing actually turned into a debate over whether XM Satellite Radio needed a distribution license for its new receivers, such as the Pioneer Inno, that permits recording by artist or song programmed in advance.

We have a representative from the Recording Industry Association of America with us today. We were going to have an XM Satellite Radio representative as well, but they decided not to participate after the RIAA sued them, so thank you, Mitch. I suspect, however, that we'll hear a point of view very similar to XM's from our Consumer Electronics Association representative today.

Now we've put bios on all four of our panelists on the table, so I won't belabor their backgrounds, but let me briefly introduce them. Our first panelist is Mitch Glazier, Executive Vice President for Government and Industry Relations with the RIAA. Before joining the RIAA, Mitch was dealing with these very issues as Chief Counsel on the House Judiciary IP Subcommittee.

Our second panelist is Michael Petricone, Vice President of Government Affairs for the Consumer Electronics Association. He frequently speaks and testifies on these issues before Congress and if I am very nice to him today, it's because I'm hoping that he'll give me a VIP Pass to the next Consumer Electronics Show in Las Vegas.

Also joining us today is Lee Knife, General Counsel for the Digital Media Association, which represents webcasters. I think Lee is perfect for this panel since he has spent 15 years dealing with these issues in the recording industry with labels such as EMI, BMG, the Sanctuary Group and Polygram.

Another expert on the arcane world of music licensing is Christian Castle, our final panelist. An LA-based entertainment lawyer -- and Chris, thanks for flying out for this --

Chris' clients include a number of labels, artists and technology companies. Now his background in law is more than sufficient to qualify him for this panel, but as some of you know, I have a bias for artists in this debate, and before his legal career, Chris was a working musician performing with artists such as Jesse Winchester, Yvonne Ellerman and Long John Baldry.

I've asked each of our panelists to give brief opening remarks letting us know their thoughts on music licensing and the PERFORM Act. After that, I will give the panelists a chance to respond to each other. Then I'll ask a few questions and then we'll open it up for audience questions.

Mitch, if we could begin with you, and then just go down the row.

Mitch Glazier, Executive Vice President for Government and Industry Relations, Recording Industry of America Association: Thanks for coming today. It's a terrific turnout which says that it's recess and the lunch is pretty good, and I hope that you're also interested in the topic that we're going to be talking about today.

It is incredibly complicated, unfortunately polarizing, and we think very necessary. We basically have the typical situation where technology leaps ahead. Laws, however, were created around particular technologies and can't leap ahead to the extent that the technology does. As a result, you have certain technologies being covered by legislative licensing provisions that were negotiated, adopted or implemented at the time that the technology was created and written specifically for what people knew about that technology at that time. There is a pretty easy explanation as to why the copyright licenses for satellite technology are different from Internet technology and cable technology. That is because they were done at different times based on what we knew about those technologies.

So, for example, you have a bizarre situation where in 1998, when the Internet provisions of the copyright licenses were written, the Internet was viewed as a giant copying machine. There were provisions put in the law to make sure that Internet radio companies couldn't, in technical terms, cause or induce the making of a phono record.

What does that mean? It means you're a radio service. You can't allow consumers to keep something that will substitute for a sale. There's a difference between radio and selling music. The idea was to make sure that there was a line there, and so a webcaster under current law cannot cause or induce the making of a phono record.

However, that same provision doesn't apply to satellite radio companies or the radio channels that you get on DirecTV or on Comcast because those were written three years earlier. At that time, satellite companies weren't viewed as being giant copying machines. So the 98 amendments that applied this certain requirement to Internet technology grandfathered in satellite and cable technology and you now have a disparity.

So you have digital radio services offered across several different platforms now. You have it across the cable-like platforms, satellite radio, Internet radio or webcasting and now across over-the-air high definition radio. All of them are digital radio services. All of them are now converging to the point where, through technology or devices, they can offer similar types of products to similar consumers, and they can start competing head to head.

If you want to see evidence of them competing head to head, just look at advertisements in the marketplace. Look at what they're saying with the roll-out of HD radio. Look at what XM is saying about Sirius and what Sirius is saying about XM. Come attend one of the debates where the parties are talking about their offerings and what they're bringing to the consumer.

This is good for music. The devices, the exposure and all the new platforms are all good for music. I think our company's perspectives are that all of this is terrific and will help consumers even more in the digital age. But there has to be fair competition among platforms and providers and there has to be an adequate system for licensing and compensation.

In the way that the licenses work, there's a wall. The government compulsory license applies to performances and broadcasts. It applies when you are streaming your digital radio and a consumer is listening but not keeping a copy.

There is a difference between that and selling music when the consumer keeps a copy to enjoy that they can listen to when they want. If you want evidence of that, look at the different models that are licensed in the marketplace right now. Take a company like Rhapsody which is owned by Real Networks. They have three different types of licenses that they operate under right now. One of them is the government compulsory license for their radio service and two are done in the private sector which is where most licensing should be done.

One of them is for a subscription service. It's an all-you-can eat model where a consumer pays \$12 to \$14.95 a month. They rent their music. They get all that they can handle, and the music is tethered to the subscription. It's like HBO. You stop paying your \$9.95, \$12.95, \$14.95 a month, your music goes away.

There's a second license that they have, similar to iTunes and other download services where a consumer owns the music. They pay 79 to 99 cents for the track, and they keep it. So you have two types of marketplace licenses where a consumer can keep a copy. And you have a government compulsory license where there's a performance only and the consumer listens to it.

Now, that's what happens when somebody's licensing and doing what they're supposed to do under the rules. The question is, when there's convergence, when a satellite radio station can do the same types of things that Rhapsody is doing, should they have to get the same types of licenses that Rhapsody has to get? We think that they should.

We think that if you're talking about fair use or you're talking about TiVo-like capabilities where you're recording by time, program or channel, you don't need a license for that. However, if you're talking about substituting a sale by offering a consumer something that they can keep where they otherwise would have paid for the benefit of the music provider, then you do need a license.

In other words, we're going to use this functionality to lure subscribers so we get more people to pay \$14.95 a month to the provider. Then you have to go out into the marketplace and license the music creator. The PERFORM Act is about harmonizing the law so that if you are enabling the making of a phono record, or if you're offering something to the consumer to keep, that would approach a sale or substitute for a sale. Then you would have to go out into the private marketplace and get a license to do that.

If you're just offering TiVo or you're a performance service, you don't. It would apply across the board to everybody, satellite, cable and Internet. It doesn't apply to over-the-air radio because they are exempt from that. You may have heard about the audio broadcast flag debate. The audio flag legislation which is in the Commerce Committees right now, imposes the same sort of structure on over-the-air but does so through FCC and spectrum instead of through the copyright licenses.

So, we are trying to assure a technology-neutral manner of adopting in the marketplace licenses that work in the digital age where consumers can get all the functionality they want. It's just the creators are compensated for them instead of sales being substituted so that the digital age produces less music rather than more. It's that simple.

Michael Petricone, Vice President of Government Affairs, Consumer Electronics Association: Mitch, you sure convinced me. I'll pass. I'm glad Mitch thinks these are terrific devices. I wish he'd tell his attorneys to stop suing me. We'd all be much better off.

Before I begin talking about the statistics, I just want to start with a quote. The quote is, "I foresee a market deterioration of American music and musical taste. An interruption of the musical development of this country and a host of other injuries to music and its artistic manifestation by and the virtue who are riding the vice of the multiplication of these various music reproducing machines."

This was Mitch last week. Just kidding, this was John Philip Sousa in 1904, over a hundred years ago when he came to Congress, asking that it stop the production of these player pianos because they were going to be the death of the music industry. If you look back historically that was the same reaction that the music industry and Hollywood had to music on the radio, television and VCR. I remember the Betamax was to the American movie industry what the Boston Strangler is to the women at home, according to Jack Valenti, TiVo, the MP3 player and so forth.

I'm giving you context because it is important. The fact is that for over 100 years,

virtually every new consumer music technology has left the music industry running to you or running to Congress saying that this is going to be the ruination of the industry and demanding that something should be done about it.

Usually you've had the wisdom to say no. Now this is kind of a Groundhog Day argument, and we're back, and now the target is this device. Now, maybe they're right. Maybe the sky really is falling this time, but again, given the context and history here, I think you've got the right to be skeptical.

Now, let's talk about the product. Now as Mitch said, the law distinguishes recording radio transmissions for personal use from distribution by downloading services like iTunes or Rhapsody. This is not like iTunes. This is like recording off the radio. You can't choose what you get to hear. The DJ plays it or not. You can't move the songs off the device or burn them to a CD or move them to your computer, and they disappear. They go poof if you stop your subscription.

What these products do is allow you to time shift the programming you've lawfully accessed through your subscription. Now these products allow exactly the kind of recording covered by the Audio Home Recording Act. There are royalties paid on every one of these devices sold under the AHRA that go to songwriters, performers, music publishers and record labels. So Mitch says we've got to make sure the creative people are being compensated. They are being compensated.

Now, the Audio Home Recording Act was fully intended to cover digital audio recording technologies that record from broadcast transmissions. That was understood under the law. As a matter of fact, if you look at the Audio Home Recording Act under the very important section, "Entitlement to Royalty Payments," which RIAA helped write, royalty payments are due when a musical work or sound recording has been distributed in the form of a digital music recording, analog use of recording, or disseminated to the public in transmissions. And this is a transmission.

That's why during the debate on the Audio Home Recording Act, Jay Berman, the head of the RIAA, said that this bill will eliminate the legal uncertainty about home taping that is part of the marketplace. Also, that this bill will bar copyright infringement lawsuits on both analog and digital audio home recording by consumers and for the sale of audio home recording equipment by manufacturers and importers. It will thus allow consumer electronic manufacturers to introduce new audio technology into the market without fear of infringement lawsuits. If only that were so.

So, again, these products are perfectly legal, covered and anticipated by the Audio Home Recording Act. Of course, in addition to the Audio Home Recording Act royalties, XM and Sirius also pay the recording industry tens of millions of dollars a year in performance royalties. This is more than all other payers combined. Of course, broadcast over-the-air radio pays zero.

Now let's talk about what these devices don't do. They don't enable audio recording.

You cannot go out and find every Led Zeppelin song out there and record it. It will not do that. There seems to be a difference of question of fact in there. That sounds like an interesting product, but that product is not for sale, and that is not something that these products do.

They don't allow digital copying or uploading to the Internet. So this is not about piracy, Internet or peer-to-peer. This is about what consumers can do for non-commercial purposes with their lawfully accessed content in their private homes and vehicles.

So, I guess I'd just to sum up by saying that satellite radio is one of American's top 21st century technology success stories, and most important they're doing it right. They're providing over ten million Americans with lawfully new exciting services. They're following the laws that Congress designed to apply to digital music recorders. They pay compensation to songwriters and music publishers through the Audio Home Recording Act, and they pay tens of millions of dollars in royalties to the music industry.

So at CEA, we are fully committed to ensuring that artists and copyright holders are compensated under the law. We are also committed to standing up for the rights of innovators to bring new products to market and the rights of consumers to exercise their normal and customary fair use rights, like recording off the radio. Thank you.

Lee Knife, General Counsel, Digital Media Association: We at DiMA have a middle-of-the road approach from what you've heard so far. With regard to the PERFORM Act itself, we largely support the Act and the measures that it's trying to make. Most importantly, some of the things that Mitch talked about in regard to arriving at a parity and an even playing field concerning the royalties that would be paid across different technologies, devices and media.

That's one of the biggest problems that we face from the DiMA prospective and it's certainly one that we think the PERFORM Act is doing a good job of trying to address. We also happen to agree, however, with the idea that the PERFORM Act is trying to protect the copyright owners and artists from services that might otherwise substitute for legitimate sales of music and might act as substitutional for other types of sales of music. We wish that the Act would go a little bit further in addressing some other issues that pertain to the areas that we're talking about in terms of compulsory licensing and the rights to exploit music.

We'd like to see the Act address the idea of interactivity and try to clarify some of the issues around the various technologies in the media. And more clearly define what is interactive and statutorily enabled radio and Internet radio versus what is truly interactive and can be deemed substitutional for the sales of records.

We'd also like to see it resolve some of the issues regarding what our ephemeral recording, or the equivalent of ephemeral recordings, with respect to digital services. Historically, ephemeral recordings have been exempted and terrestrial broadcast radio has been allowed to retain ephemeral recordings for the purposes of advancing their

businesses. And the technology behind digital radio causes digital radio services and the Internet-based businesses to have to several different server copies and various copies that go through the stream of delivering digital audio.

We'd like to see the Act go further and more clearly address the issues surrounding the use, the value of licensing and royalties, if any, that would be applicable to those types of uses. That's really it for now other than discussing it.

Mr. Ross: Great, thank you. Chris?

Christian Castle, Intellectual Property Attorney, former Vice President, Business & Legal Affairs and General Counsel, SNOCAP: I think it might be helpful to put this sound recording performance in an international context for everyone.

The United States is really the only country, I'll say in the world, and I'm probably wrong, but about 98 percent sure, that doesn't pay a royalty, recognize the right of a sound recording owner or artist whose performances are embodied in that sound recording. They don't receive a royalty of some kind when that track is played in any broadcast or other performance setting.

There's an organization in the UK called Phonographic Performance Limited that collects a lot of this money, and in 2004 those collections were about 80 million pounds. It grows at a rate of about three or four percent a year it would seem, so you can do the math on that.

So this is not the trivial amount of money that's collected internationally and paid out to record companies, both featured and non-featured artists. We don't have that here for terrestrial radio. So when people talk about taping off the air, it's not as if that implicates any right on the sound recording side on terrestrial radio because artists don't get paid when records are played on terrestrial radio. Record companies don't get paid when records are played on terrestrial radio. In fact, the only place that artists and record companies do get paid on any kind of radio is if it's performed on the Internet, or digitally, by satellite, on cable and so on.

Granted, they do pay some money for that, but it's important I think to understand that the rest of the world has no question in their mind that artists and record companies should get paid anytime a sound recording is performed in any public performance setting.

So, that's an important thing to keep in mind when you start comparing things to TiVos, recording home taping off the radio and mix tapes of things that you put together off the radio like when you were a kid; all these sort of analogies that people make that are really not that accurate.

So from an artist's perspective and an artist's representative perspective, it's important what happens here because ultimately, the real fight is going to be on terrestrial

broadcast radio. And I think that fight is coming as we see digital radio start to come online and the difference between digital radio from a stick and digital radio from a satellite becomes less and less easy to distinguish.

Not to insult anyone, but I'm always struck by how technology companies view music licensing. At one point when I was younger and more cavalier, I used to liken it to that beginning section of 2001 where the monolith kind of appears and they're all sort of mystified by it, because it's not something that any technology company really ever comes in contact with. I mean to say to someone at a tech company, "Well your programmer should own a code or should get a revision in the code that they create or should get a royalty for the code that they create." It just doesn't compute; they just don't know how to react to it.

They give him some stock, and if the programmer is lucky enough to stay with the company over the years that his stock, his initial options vest and so on and all the different stock option issues. Then, yes, maybe if good things happen and the company eventually goes public. Eventually, way, way, way down the line, the programmer may actually get some money for it, unlike an artist and a record company. These much-maligned record companies, that spend a lot of money to promote artists and artists who go out on tour and put their own blood, sweat and tears in developing their product.

These people expect to get paid whenever anybody makes money off of their music. I think that is sort of a fundamental fairness question that has to be looked at whenever you're looking at devices, services, or anytime anybody makes money off my clients' music. I think we have a reasonable expectation of getting paid, not to mention the songwriter who is often the person who's completely overlooked in this entire process. This is because he is the person who just writes songs. He is not an artist, he doesn't tour, he just sits and writes songs and tries to get covers on those songs. Meaning, he tries to get an artist to record his song and put it out there; which you see a lot of in places like Nashville and less of in places like New York and LA anymore.

I think those people are getting hurt the most by vouchering with all the leakage in this system. You rarely ever see people staying up late nights worrying about the songwriter. So I think that when you look at what's going on with these devices, songwriters, arguably, should probably get a mechanical royalty for the download off of the service. Record companies should be able to collect a royalty for the sound recording piece, and then there will be a fight, of course, on the record company's side between the artist and the record company as to who gets what. But some of these things have been decided, and it seems very obvious to me that these devices are distributions of permanent copies.

Back to my point about the tech companies, it's entirely possible that people went into this with the best of intentions thinking that they were within the law. I've had companies come to me having spent extraordinary amounts of money. One, I can think of off the top my head, spent \$70 million developing a product which was going to have obvious music licensing problems.

Had they talked to anybody at the beginning, they probably wouldn't have done the product. When they came to me they were saying, "Could this possibly be true that we have to go ask this person, this person, this person and this person? Because when we hire a programmer, we don't have to talk to them ever again."

So you have a situation which unfortunately is going to get resolved in court, because XM, which I'm not part of, apparently didn't. When I see that case, I think of the MP3.com case. I had guys from MP3.com call me, weeks before Michael Robertson bet the company on My MP3.com which he eventually had to deed over to Universal, actually believe that they were in the right, thought everything was fine, and as soon as the thing went up, they were dead meat. I told them they were dead meat and they ignored me. Now that's why they were dead meat.

[Laughter]

But they went out and did it anyway. I sat there and I watched them. I watched them throw the company down the drain.

So it wouldn't be the first time that a tech company came to these situations with the best intentions wanting to have a product that satisfied consumers that was innovative and interesting, but just didn't know the right rights. One of my old bosses used to say, "I find the rights are a good place to start," so on that note, I will leave it to you.

Mr. Ross: Thank you, Chris. I'd like to give our panelists a chance to respond to some of the comments, and I think Michael had some words to say.

Mr. Petricone: Yes, first of all, it's interesting to be lectured on our cavalier attitude toward licenses by a guy who is representing a company that was founded by the guy who founded Napster, but that's a different issue.

I think the reason that XM and Sirius went forward on this thinking that they were within the law is because, in fact, they were within the law. These are not distributions, these are transmissions.

Once again, it's not like iTunes where you sit down and pipe in Red Hot Chili Peppers and download their new record which you can then move to your iPod or your computer, or what have you. It's like the radio. You get a song if the DJ plays it which may be tomorrow, which may be never. It's like the radio in that the DJ may be talking over the first part of the track. The end blends into the next track, and so forth. But it's clearly not a distribution.

Again, this is exactly the kind of recording that was contemplated under the Audio Home Recording Act. I think one of the most interesting parts of the lawsuit the RIAA filed is that the Audio Home Recording Act is never mentioned anywhere. If only it were that easy to white out parts of the statute book, but it's not. It's the law and it applies.

The final point I'd like to make is on the PERFORM Act. It is not just a matter of preventing it from recording all the Led Zeppelin songs. The technology mandates in the Act, are much more stringent. It would prevent you from recording, let's say, three songs and then listening to them in the order that you want.

For example, if this were applied to the video world, let's say you're going out tonight and you want to set your TiVo to record the Heat vs. Pistons game tonight on ESPN. Well, if this applied to the video world, then what you'd have to do is record ESPN from six o'clock to eleven o'clock. When you wanted to watch it you can't go to that program and you can't fast forward. You've got to watch the whole thing.

Finally, the last point is that people keep on talking about how this is going to bring equity, about platform equity and, in fact, the title of the bill is the Platform Equity Reform Act. This has nothing to do with equity. This doesn't impact analog over-the-air broadcast radio which pays no royalties. This doesn't impact digital over-the-air broadcast radio which pays no royalties. This doesn't in any way impact recording a digital stream over the computer. This specifically singles out one technology, this technology, for punitive new fees and tech mandates. So this has nothing to do with equity at all. It's a matter of singling out one new service that, in fact, is legal under the law.

Mr. Ross: Mitch?

Mr. Glazier: Oh, my. If you can't get all equity, you ought not get any, is the theme of what you're saying. I think if you can get some, you ought to get it. Let's keep moving forward and eventually get it all is what I would think.

I also think that the drafters of the PERFORM Act did a very good job of being practical and reasonable because what you're saying is, of course, just not true. It says that you can record by time, program, or channel. So if you want to record a program, you can record it by the program. So if you want to record the Heat game, then record the Heat game and watch it later and time shift. That's okay.

What you can't do is the equivalent of saying, "I want to record Saturday Night Live, but I only want to record the band performance of Saturday Night Live. I want to cherry pick just that performance out, but I don't want to tape the rest of the show." You can't do that.

You record the show. If you fast forward because you want to see the band, you fast forward because you want to see the band. Consumers don't seem to mind that inconvenience of fast-forwarding when they're automatically recording in that fashion especially if it means that there's going to be more content produced in more ways, with more functionality for them later on.

They also don't seem to mind buying music. It only seems to be multi-billion dollar

corporations that mind paying for music. Consumers say that they're very happy to pay a couple of bucks more a month to be able to keep music or 99 cents to be able to keep a track. So this is not a consumer problem. This is the problem of companies trying to figure out where they can cut corners.

They don't mind paying \$3 billion to roll out their system. They don't mind paying billions of dollars for satellites. They don't mind paying for all of their technology, and by the way, they pay market rates. There's no compulsory license that lets them get their consumer electronics products at a cheaper subsidized cost. And they have no problem paying all the patent fees for all the consumer electronic devices that they use in all of their products.

The only thing that they want to cut is what they pay for music. It'd be like a restaurant saying, "Okay, I'll pay for the rent and I'll pay for the air conditioning and I'll pay for the silverware, but I'm just not going to pay for that food because, you know, that's just unfair." So from our point of view this is a step towards equity, and it's really, really important.

The other thing is, if you're saying that this doesn't enable a recording and that it only allows time shifting and consumers to tape off the radio like they always have, then you have nothing to worry about because the PERFORM Act only prohibits the enabling of a recording. So if it's not enabling, don't worry.

It only says that other than time shifting and manual recording, it's the automatic cherry picking substituting for a sale. That's what prohibited. If it's not doing that, then you have nothing to worry about. So the good news is that the tradition of consumers doing what they do on the radio without paying is preserved. But, new companies taking advantage of technological innovations to lure subscribers for their own profit without paying for the substitution of a sale to the creators who are providing the product that they're making their money off, is just ludicrous.

You have 120 channels, 69 are dedicated to music. Every poll shows that the number one reason why consumers go to these services is because of music. So let's pay in the marketplace for the music. If you can pay Major League Baseball 150 million bucks, if you can pay Howard Stern 600 million bucks and if you can pay Oprah 50 million bucks, then why can't you pay in the marketplace for the music that's actually attracting the people who are paying the subscriber fees that's giving you the money to allow you to operate in the first place? That is the equity that we're talking about.

Mr. Petricone: Mitch, we're paying. I'll pull out my wallet and pay you more. I mean, we're not Napster here. I'm sorry the 'old' Napster. We're paying tens of millions of dollars in performance fees. We're paying royalties on every one of these devices onto the Audio Home Recording Act.

Mr. Glazier: That's like saying I pay for the concert. I don't want to pay for the seating.

Mr. Petricone: No, no, no. We're opening up broad new revenue streams for the record industry. If you want to tell me, "You know something, we're getting a lot of money here, but you know something, we want more," then I'm okay with that, but don't say we're not paying. You're getting compensated very well.

Mr. Castle: Can I just ask a question?

Mr. Ross: Yes, go ahead, Chris. Then we're going to go into questions.

Mr. Castle: Okay, so, Mitch, I actually see Michael's point about why the lawsuit doesn't mention the Audio Home Recording Act. I don't know what the strategy was, but in reading it, I think the reason it seems to me that the offending part of the chain of distribution is more the service...

Mr. Glazier: Correct, not the consumer electronics maker. It's not even his client that we're suing.

Mr. Castle: Right, so in other words, the point is that...

Mr. Petricone: You're suing our members.

Mr. Glazier: Who's your member?

Mr. Petricone: XM.

Mr. Glazier: Oh, I didn't know they were members.

[Laughter]

Mr. Glazier: If I had known they were members, we never would have sued them.

Mr. Petricone: There you go, may the wrath of CEA come down upon you.

Mr. Ross: Oh, dear. I actually want to follow up on what Chris said there because, Michael, you brought up the Audio Home Recording Act several times. I think it would be helpful to get more clarification on where exactly this fits into the debate. Mitch, if we could start with you.

Mr. Glazier: Yes, this is one of the great red herrings of all time. Maybe that's why it wasn't mentioned in the lawsuit. The Audio Home Recording Act, which was passed in 1992, addressed consumer electronics manufacturers making off-the-shelf products that would lead to consumers engaging in serial copying that would allow no degradation of quality. So you had a digital audio tape, remember those? Never really took off.

There was a big fear that consumers would have a tape-to-tape deck,... so just by my terminology here I think you're sort of understanding the difference between what this

law was aimed at and what's happening now.

You had a tape-to-tape deck where a consumer would be able to put a "master purchase digital audio tape" in one side, and then they would be able to put a blank tape in another side. They'd be able to keep making tapes and there would be no degradation of quality, and they'd be able to give them out to the rest of the world. So that's the idea of the Audio Home Recording Act, a very silly Act, which I wasn't around for at the time. I'm sure Jay Berman loved it. I don't think it's so great, but anyway, it went into law.

It basically said that if a deal is struck where technologies incorporated into the device that would prevent serial copying, the copying of a copy, and in addition if a small capped revenue was paid on both the device and the media -- in other words a tax put onto the device and the blank media -- then the consumer electronics manufacturer who made the off-the-shelf device that the consumer is using to engage in this serial copying, will not be able to be sued for contributing to the infringement of the consumer. So that was that scenario and what that law applies to. Okay, now we have a service. We have a service that's like XM. It's not that we're suing Samsung. We're not suing Pioneer for making an off-the-shelf recorder that a consumer is using. We have a service like XM that has a direct connection with the consumer, so the broadcaster is now in control of what the consumer receives in a direct connection, and the broadcaster is saying if you will come to me and pay me X amount per month, I will give you a service that allows you to keep the songs that are broadcast off the radio in a manner that is very much like a subscription service. I will alert you when a song is being played so that you can manually record it whenever you want it, and I will give you this -

Mr. Petricone: It doesn't do that, Mitch.

Mr. Glazier: I've had the device. I've been alerted.

Mr. Petricone: Well it does not do that.

Mr. Glazier: It does do that.

Mr. Petricone: It doesn't do that.

Mr. Glazier: It does do that.

[Laughter]

Mr. Ross: Maybe Mitch has a different version.

Mr. Knife: Maybe there's a difference between a service and a device. Does a service do that, Mitch?

Mr. Glazier: Yes, if you want to know when something is playing on a particular station, you will get a little alert, and it will tell you what channel to go to.

Mr. Petricone: But it doesn't automatically record it.

Mr. Glazier: I've said the word manual.

Mr. Petricone: That's fine.

Mr. Glazier: Okay.

Mr. Petricone: Okay.

Mr. Glazier: All right, so anyway. You were just trying to throw me off track. I was in the groove. Michael, where was I?

Mr. Petricone: You're doing fine.

Mr. Glazier: Thank you. Anyway, the point is that the Audio Home Recording Act, written in 1992, did not conceive of this, isn't aimed at this and doesn't apply to these types of services. That is why it is not the subject of the lawsuit. It's not the subject of legislation right now. It is the grand red herring *du jour* that Michael will now obsess about.

Mr. Petricone: Yes, let me respond to that. As you can image, Mitch has a somewhat narrower interpretation of what the Audio Home Recording Act covered than I do. Fortunately, mine is in accord with Congress. Let me read you from the House report. "Also, the reported legislation will cover all digital audio recording technology that now exists and is developed in the future."

Mr. Glazier: That sounds...

Mr. Petricone: Wait, I'm not done. "The Audio Home Recording Act of 1992 is designed to put an end to these debates where it were so and facilitate the wide-scale introduction of digital audio recording technology to the American consumer." Now you may look back and you may say that's silly, but I think it's pretty plain what was intended here and what Congress thought it was doing.

Mr. Ross: Let me jump in here if I could, Michael. I'd like to bring Chris in on that. We've observed the marketplace since this Act was passed. How effective do you think it's been and what's your reaction to the way it's turned out?

Mr. Castle: Well, I also did a little bit of the Rio case which is the only win on the other side, so I've been on both of this. One thing about the Audio Home Recording Act, I believe there's an audit provision in the Audio Home Recording Act, isn't there? Has anybody ever been audited under the Audio Home Recording Act?

Mr. Knife: Good question. I'll look.

Mr. Castle: So I guess we'll just take you at your word that everybody's paying what they're supposed to pay for all of the licenses you're supposed to pay it on and all the media they're supposed to pay it on too, right?

Mr. Petricone: Lee, do you have any reason to believe they're not?

Mr. Knife: I think what he's alluding to is if you go into Best Buy, you can buy a big giant spindle of a million blank CDs and of course you can use them to record music. There's no tax paid on them, but if you pay \$2.99 in a nice jewel box that says music on it for these same exact CDs, then you pay the tax. In other words, the fact is that they only pay on things that are purposely packaged and more expensive when the exact same product is offered without the advertisement, which you can buy it for nothing and no tax is paid.

Mr. Castle: Yes, I don't think anybody denies that these products are covered under Audio Home Recording Act and royalties aren't being paid.

Mr. Ross: All right, well let's move on from there. We've been talking about this whole issue about the distribution versus performance license, but I'd like to get back to something I mentioned in the beginning about the fair market value provision of licensing. I've watched the CARP (Copyright Arbitration Royalty Panel) proceedings over the years. I know we have this new copyright royalty board or something. I'm sure they're going to be miraculously better than the CARPs were. I have every confidence in that. But I can't figure out exactly what fair market value is. I know what it is in the market. I don't know what it is in a licensing regime, so I was hoping to get some enlightenment on that, Mitch.

Mr. Glazier: Well, if you ever become enlightened, please share it with me. The problem with the compulsory license is that it's a government license. It's not the marketplace. It's never going to give you the money that you would get in the marketplace because it's the government, it's not the marketplace. So all it can do is try and mimic the marketplace as much as possible by guessing and looking at some evidence that might be available in the marketplace that it can then adapt and perhaps adopt.

So all we can try and do for a rate standard in these government proceedings is force them to the extent possible to mimic the marketplace as much as possible. They know that they're never really going to replicate the marketplace. So the idea here is to put a fair market value standard in, which is a standard used in other compulsory licenses, the arbitration code of the United States and in the United States about 500 times in lots of different scenarios. So there's not a mystery here.

But to try to make sure that the value of the music ascribed by a board of three people

for an entire industry mimics what you would otherwise get in the marketplace, when the standard exists right now for some services but not others, points to a disparity here too, which is why parity is important.

If you're a webcaster, the standard is what a willing buyer pays a willing seller in the marketplace. It is sort of a microscopic definition of fair market value, but the satellite guys pay under what's called the 801B Standard which is sort of fair and equitable which takes into account a bunch of factors. In the only decision that has ever been released under that standard for this particular purpose, the arbitrators stated in the opinion itself that this was a below-market value price.

So what we're trying to do is, again, take a step toward equity and make sure that they are forced to at least consider a standard for everyone, that's fair to each party, where everybody pays under the same rate, which mimics the marketplace as much as it can be mimicked in a Government licensing law.

Yes, I mean that all sounds quite reasonable with fair market value, except in this situation there's no market. What you've got is four or five major record labels, but there's not a free market. It's an oligopoly, and that's why, the reasonable return standard means sense.

Previously, when we tried to use the fair market value standard in the webcasting context, Congress had to come in and reduce the rate by about 40 percent. You can't say "fair market value" when there's no market. You can't have it both ways. You can't have a government license which says that the companies can't go out in the marketplace and negotiate separately and fairly and then impose a government license and say, "Well, there's no market." So now they're using their power to get an unfair price.

Either don't have the government license and allow the marketplace to work or have a license and for convenience purposes allow the industries on both sides to negotiate collectively because there's no danger of anti-trust violations because at the end of the day there's a government rate that's going to be the "be all and end all," instead of a market rate. And also, do it in a convenient way that allows your companies to deposit one check with the government instead of paying us in the market.

Have either that you like. We'd prefer the former rather than the latter. We'd prefer to repeal the license than to do this in the marketplace where there are none of these issues or problems, but if you're going to impose a government licensing structure to deplete a marketplace, don't complain that there's no marketplace and that it's all been depleted.

Mr. Ross: I'd like to bring Lee into the discussion if I could because you have some of the companies that are under the name willing buyer and willing seller that we just heard about. How do you feel about a shift to fair market value?

Mr. Knife: We're for going to a fair market value or an 801B-type standard generally because right now, we're involved in a CRB (Copyright Royalty Board) proceeding that uses the willing buyer and willing seller standard. Mitch makes kind of a good point in that all of these things, ultimately, grind it down to being a battle of the economists essentially because there is no marketplace you can really directly point to. So everybody fabricates some analogy to what they think is the closest thing to the marketplace. Clearly the bias is in how you establish those models. But, I think the 801B standards and the idea of a real fair market value are more attractive to us than the current willing buyer, willing seller standard.

Mr. Ross: Okay.

Mr. Knife: It just has more fair factors involved.

Mr. Ross: I'd like to move on. We've heard a lot of talk about terrestrial radio and the broadcasters. We know that they're under a local service area performance right exemption (no licensing needed to broadcast music) and that's something that's very important to them to preserve, I would have to assume.

We have not talked much about the copy protection mechanisms that one would adopt under these licenses, but what we're saying is that the broadcasters are concerned about having them applied to their digital services which, correct me if I'm wrong, would include the HD radio as well as their Internet simulcasting.

But I gather their argument is that if they could keep that performance right exemption and apply it to their Internet simulcast within a 150-mile radius, their local listening area, they would actually be okay with reasonable technology protection mechanisms. So I'm curious particularly, Mitch, about what people would think about a compromise like that.

Mr. Glazier: Well, I don't think it's a fair trade when they're not paying us money for over-the-air now. There is an inequity between the DiMA folks and the satellite folks who do pay and the terrestrial guys who don't, and this would increase that inequity by furthering their exemptions. The only thing that they do have to pay for now is simulcasting their signal on the Internet, which under this proposal they also wouldn't have to pay for.

I think you're talking about apples and oranges. One is money and the other is content protection. What they want to do is trade money for content protection and basically say, "Hey, if we aren't to pay anything for over-the-air now but if we don't have to pay you for simulcast either, maybe we'll consider protecting your music."

I mean, come on, you should protect their music. This is helping you. We are providing the creations with all of our partners that you are making money off of, and you certainly care about signal protection. I mean, everybody believes in protecting their signal. If you're a satellite company, you encrypt your signal so no one can steal it. If you're a radio company, you would like to make sure that you have a signal protection that's

recognized worldwide so no one steals the signal because you need the Nielsen ratings on the advertisements to make your money.

But stealing the music contained in the signals, that's somebody else's problem: "If they pay me, maybe I'll protect their stuff too." I just don't think that that's a fair trade from a policy point of view. I think that if they are bifurcated then let's deal with content protection, and we should deal with payment when we can.

Mr. Ross: Now, Mitch, when you say "stealing," you mean stealing or simply recording free over-the-air broadcast radio?

Mr. Glazier: I was using the word "stealing" with regard to signal protection, and I think that any broadcaster or webcaster would tell you that if you take their signal in a way that they don't authorize, they would call that "stealing."

Mr. Petricone: Yes, I have a couple of points here. Number one, clearly we regard recording free over-the-air broadcast radio as fair use as recognized by Congress. Consumers have been doing it for decades, which is very different from mass indiscriminate redistribution of over the Internet, which we all agree is bad.

I think the issue of performance rights and what the obligation should be on broadcast radio is an interesting discussion. Again, satellite radio is paying tens of millions and broadcasters are paying nothing.

You've got bizarre results. You have record labels who illegally pay radio stations to play something, give them money and meanwhile the same record labels are demanding enormous sums from XM and Sirius for playing music. So the whole thing is a bit odd.

Once again, as far as content protection, I think we all agree that preventing mass indiscriminate redistribution is okay. Unfortunately, many of the broadcast flag proposals that have been introduced go way beyond that and also impact consumers' non-commercial use at home for private purposes. And that's something that we think should be protected.

Mr. Ross: Lee, do you have some comments?

Mr. Knife: We just really think that the two issues shouldn't be joined. Obviously with regard to the 150-mile exception, I would echo some of Mitch's comments. I mean, the big elephant in the room that isn't really being discussed is the fact that terrestrial radio gets their broadcast rights of the recordings for free. To extend that now to any type of Internet or digital-based broadcast just because it happens to occur in a 150-mile radius of the broadcast towers, seems to me that it just goes overreaching with regard to trying to offset that by some type of content protection. We disagree with the idea that those two ideas should be intermingled at all.

In terms of content protection, as far as we're concerned, it seems that content protection should really only apply to those types of services that are engendering the retention of the content and the further use of the content by the end user.

Mr. Ross: Could you elaborate on that?

Mr. Knife: Well, I think the idea is that you shouldn't be obligated to employ some type of DRM that's set by somebody who doesn't have anything to do with your business. You shouldn't be forced, either economically or technologically, to adopt some procedure to protect content unless you are actively soliciting the further use of that content.

In other words, if you're just broadcasting, if you're just sending the signal out, and you don't have a business model, you don't have a technology, you don't have a service or a device that enables or entices the end user to retain the material that you've broadcast, you should really just be able to freely broadcast. You shouldn't be strapped into some type of DRM system that has otherwise been established by someone. So that's the view regarding content protection.

Mr. Ross: Doesn't the webcast industry by and large use a certain kind of DRM?

Mr. Knife: There are certain types of DRM that are used depending on the technology that's used.

Mr. Ross: And they do that voluntarily or is that a legal mandate?

Mr. Knife: I think it's mandated. If I remember correctly, it's mandated if you use the technology. If it's there, you have to enable it. I think is the way it works.

Mr. Ross: Okay, Chris, did you have any thoughts on this?

Mr. Castle: Well, we haven't really talked about stream ripping here. But I'm assuming that no matter what DRM you put on, a webcast stream or any kind of streaming signal on the Internet, there are programs out there called stream rippers that will allow you to create a MP3 or .wav file from that stream.

I hope that I'm not giving anybody any illicit ideas here, but there are such devices. And there are other people who helpfully have created plug-ins for those devices that will ping the Grace Note database, for example, and conveniently load all these tracks into your iPod along with the associated metadata.

Now this is adding insult to injury if you're someone who makes a living from songwriting or being a recording artist or a musician. So when you talk about DRM for the webcast signal, that's fine except that it doesn't really go far enough because of these stream rippers which actually are creating or adding to a fairly significant problem.

Mr. Ross: I know the PERFORM Act is not technology specific. Instead, it just defines a general approach. Would it cover stream ripping, Mitch?

Mr. Glazier: No.

Mr. Petricone: Yes, it does.

Mr. Glazier: I don't agree with you.

Mr. Ross: Okay, but there's a provision in the PERFORM Act which says that if you are under the copyright license, then you need to employ anti-stream ripping technology to prevent the problem that Chris just illustrated. That is if it is reasonably available in the marketplace, technologically feasible and economically reasonable.

Mr. Petricone: Yes, I guess our issue is that speaking to the larger issue of recording over the Internet, the PERFORM Act doesn't apply to that except for the TPMs (technological protection measures) you were talking about. The much larger issue is over-the-air broadcasters and what there ought to be. Which is, as you said, the elephant sitting on the kitchen table, doesn't apply to that.

What the PERFORM Act does do, regardless of talk of equities, is single out one single service. Which is, unfortunately, the only service that's already paying tens of millions of dollars to Mitch's members, and we find that to be frankly non-equitable.

Mr. Ross: We've heard a lot today about how we've had laws in the past that are clearly not capable of handling today's technology and today's market offerings. I know it's good for IP lawyers if we have to keep coming back and doing this, and it also keeps the Hill staff here busy, but what I would love to see is legislation that could address the current problems but would also be flexible enough to accommodate new technologies and new services as they come, so we don't have to keep coming back to this. So I'll start with Chris and try to get some impressions about whether you think PERFORM gets there or how we might get there.

Mr. Castle: Well I think it depends on which side of the fence you're on. I would think from the label's and the artist's point of view, it goes a fair distance down the path on the digital transmission side of the house. It doesn't go far enough -- the fact that terrestrial broadcast radio is a performance royalty on the sound price, to me is something which is sort of like losing Poland. I mean, it happened, and it's been a constant fight ever since to get it back. So I think eventually we're going to get there, and this is another step down...

Mr. Ross: We're going to liberate Poland someday.

Mr. Castle: Yes, exactly. But there are some issues that weren't addressed like interactivity, for example. There are some folks that would like to have a broader definition of non-interactive because the payments for non-interactive go through

SoundExchange. What that means is that this is one of those inside-baseball things where a page in history is worth of volume of logic.

The reason why people want it to go through SoundExchange is because those monies are not paid under the artist's contract. Therefore, are not applied against unrecouped balances. To say something positive about XM and webcasters instead, there's a lot of catalog that's getting played that hadn't been played in a very long time. So these catalog artists very often are unrecouped under the terms of the contract that were negotiated. So there are no shenanigans, aside from the general shenanigans, that go on in negotiating a record deal.

So if those artists have that money from digital radio, let's say digital transmissions paid to them under their agreements and it's applied against unrecouped balances, it's like it didn't happen, right? Because they don't get any benefit from it, and these are people, very often, whose records have been deleted from the current catalog of the record company and they can't get the record company to let them put their own records out.

So it really is kind of insult to injury. However, looking at it from the record company's perspective, if you say that all digital transmissions in a world where we are moving towards involve a significant amount of revenue coming from digital transmissions or paid off contracts, if I'm a record company, I'm going to say that's fine. I'm going to reduce the advances I'm paying you, and I'm going to adjust the economics of the record deal accordingly. So that's another tension that was not addressed to the satisfaction of some people in the current draft of the bill.

Mr. Ross: Okay, Lee?

Mr. Knife: Yes, I don't know how much I can go off the script. I think I've been doing a pretty bad job of it, discovering my way through the script anyway. With regard to the idea of bringing broadcast radio into it and the idea that perhaps the Act doesn't go far enough because it leaves that outside the room that the Act addresses, I agree with the point that was made earlier. How can it be equity and how can it be parity if truly everybody whose involved with the business isn't at the same level? I think that's true.

Ideally, we would love to see complete parity amongst all types of formats, technology and media. I appreciate Chris saying that he may be inching towards our way, given that it probably won't happen now, and it may not happen this year or next, but it will happen sometime. We'll take what we can get right now, and to have a little bit of parity amongst the people that engage in some of the largely analogous, no pun intended between analog and digital, businesses that my companies engage in again, we'll take it. We'd rather get a little bit closer to a fully level playing field and we'll fight off each bit as we can.

Mr. Ross: All right, Michael?

Mr. Petricone: Certainly I think as technology moves forward every now and then, it's

important to look at the overall royalty structure in a comprehensive way to make sure that everyone is being adequately compensated, as opposed to singling out specific technologies and specific services.

That being said, I would like to take issue with any implication the Audio Home Recording Act is outmoded or doesn't apply. What's interesting is that every element of this device has been on the marketplace for a long time. Hand-held digital recorders were available in the 1990s. Devices that could record digital transmissions with the ability to make playlists have all been around for a long time. And what this device does is take all those functions and puts them together and just makes it easier. But it doesn't, strictly speaking, do anything new.

So just because these products realize all the aspects that were addressed in the Audio Home Recording Act doesn't mean the Audio Home Recording Act is out of date. The fact that these new devices comply with the Audio Home Recording Act should be viewed as evidence that Congress anticipated a legislative solution for digital radio and that the Audio Home Recording Act actually works.

Mr. Ross: Mitch.

Mr. Glazier: Okay, all you have to do after listening to all this legal mucky muck is look on the Circuit City website at what the consumers say about the Samsung device. "Wow, this is really cool. I'll never buy music again." Are you substituting for a sale or aren't you? What's the right policy decision?

If you are substituting for a sale, you're not performing, you're not just listening off the radio. If you're substituting for a sale, should you have an obligation to compensate for the loss of the sale to the creators of the product? That's the policy question. It really is that simple.

You have all the evidence you need from anybody whose ever played with the device and said, "This is the greatest thing in the world. Now I don't have to buy my music!" And the answer is, it's not the whole banana. It's half the banana. But it's really important and it's a necessary step. We need to do it sooner rather than later, right before the inequities get so out of whack that it actually takes the same type of toll that peer-to-peer piracy did where artists' rosters are slashed by yet another third, and the other half of Music Row in Nashville goes up for rent, and you enter a crisis where there's no product to put on these fantastic devices, so that consumers can't get the diversity that they need.

We are interconnected. We make it. They sell it. They don't want to pay for it. We want them to pay for it, and it's a question of fairness. We have to move one step closer to that before he foams at the mouth, one step closer to that end goal and PERFORM is a necessary step.

[Laughter]

Mr. Petricone: I sound like a broken record, but we're paying, Mitch.

Mr. Glazier: Can you stipulate that we're paying? Wait, let me finish.

Mr. Petricone: Am I in a deposition?

Mr. Glazier: First of all you're paying for the performance. There's a difference...

Mr. Petricone: And we're paying royalties on the device as the law says. Second of all, as far as the lost sale, do you know what the numbers say? We have data that shows that XM and Sirius subscribers, they tend to be music people. They buy more CDs, they buy more music, they go to more concerts, they discover bands on XM and Sirius because they have large playlists, and they tell their friends about them.

Our numbers show that those subscribers are your best customers. To the extent you're saying that what these are causing sales displacements and lost sales by the music industry, I'd love to see a survey, I'd love to see some facts, I'd love to see some kind of proof before we run around imposing government technology mandates on these new products. I think that's the least you can do.

Mr. Glazier: There are new technologies which is why it will accommodate the future which I think is a good step. The second thing of it is that you have to let people who have exclusive rights run their own businesses and make their own mistakes. If we're wrong and you're great for us, and we're just too stupid to recognize, that's our decision to make. But the other thing is... actually, I have a terrific idea.

We know that technology buyers usually go and buy even more technology. So we ought to have a mandated government licensing system that says that the government will set the price for every consumer electronics device that comes out, and we will only allow people to pay what's fair and equitable according to what the government thinks for that particular device. Don't worry because consumers love them so much that they're going to go out and buy even more because it's really great for your business and you just don't know it.

I mean, it's so ridiculous to sit there and say to the creators of products in business that they just don't know what is good for them and to protect their rights. "They're just idiots." It's sort of insulting. I don't know why I'm so worked up today. I think you know exactly what's good for you. Your business is an oligopoly, and you're trying to extract maximum rents.

Mr. Castle: You hear this a lot. Just because there's four major labels, and soon to be three, there's a lot of other people out there. I realize that your only contact with the recording industry is in this city, and you don't ever go to a nightclub and you don't ever go anywhere where music is being played. But you may not be aware of the fact that there's probably something close to 60,000 releases. I don't know what the number is,

but it's close to that every year. And these releases are by people that have nothing to do with any of these labels.

There's a lot of people out there who are affected by what happens and who have as much a right to step up to the table and be heard about this stuff as the majors do. In a sense, if you look at all the members of the RIAA, as well as some of the organizations that are starting to weigh in on this stuff, there are a lot of people out there that have nothing to do with the major labels. And honestly the major labels are increasingly only dealing with the hit product, because major labels are doing an increasingly worse job of developing the artist in the early stages up to 100.

I mean, you can't get to a million if don't get to 100,000. So the fact of the matter is that the people you're serving are predominantly in XM. I am an XM subscriber and I love XM. I think Lee Abrams should be the Chairman of the FCC, and that would be a trip if that were to happen. It would shake things up in a positive way I think.

But the people that you're talking to about in terms of who you're servicing are mostly not artists who are on major labels. If you listen to the stations that provide real promotional value where you're truly introducing people to new music, you've got three of four channels on XM that do that. The rest of it is all hit-driven radio. All hit-driven artists that major companies and artists and managers and publishers and a lot of other people have spent a lot of time developing and grooming, in spite of terrestrial broadcast radio. What I would say to you is that if you want to have us invest in your business, then let us benefit from the reward. So what I would suggest to you, in a good old Silicon Valley fashion, is put some stock in escrow. Have every one of your members put like a million shares of stock in escrow, and your members too for that matter.

Mr. Glazier: How dare you!

[Laughter]

Mr. Castle: We'll see, and if your up in two years from the benefit of using our product, then that's great. We'll just take all that stock and we'll distribute it out to artists and publishers and songwriters.

Mr. Petricone: You know something? Given the onslaught of harmful legislation and lawsuits, I'm sure the stock is going to do great. It's a terrific idea. First of all, certainly there are a lot of independent artists out there. Independent artists are the ones who benefit most from XM and Sirius because they're the same ones that can't break into the narrow playlists of commercial radio.

But the fact is that the major labels do represent the lion's share of the music industry. It's just a fact. And if you're going to be in this business, that's who you've got to deal with. The major labels really do, just in economic sense, have a lock on the industry. It's not a good thing, it's not a bad thing. It's simply the reality that licensees like XM

and Sirius deal under.

Mr. Glazier: Are XM and Sirius a duopoly then?

Mr. Ross: All right, moderator's prerogative here. I'm going to jump in. By the way, I hope all you reporters out there heard that the RIAA now is backing a compulsory license for consumer electronics products, so make sure you lead your stories with that.

I'm going to ask one more question, and then we're going to open it up to the audience. My question is specifically for Michael, and it's probably going to cost me that VIP Pass at the Consumer Electronics Show. It's a two-part question. First, is Sirius a member of CEA?

Mr. Petricone: Yes.

Mr. Ross: Okay. Was Sirius wrong to privately negotiate a license with the record labels for their devices?

Mr. Petricone: I can't comment on Sirius' business deals. That would be totally inappropriate.

Mr. Ross: Okay, well we just put that out there that there were two different approaches taken by the duopoly.

Mr. Petricone: No, let me elaborate on that a little bit. Getting beyond the present situation we're in now, generally speaking, where if you bring out a new product, and this is in the audio space and the video space, that allows consumers to use media in a new and flexible way, you're probably going to get sued or be threatened with being sued.

If you're a big company, if you're Apple, if you're Intel, it's in the legal budget, and you just deal with it. If you're a smaller company, new company, or start-up, that's a big deal, and it's potentially a deal breaker for you. We have a company called Cima Video Technologies that was recently sued by the Motion Picture Association. You've got companies, again very small start-up companies, like Sling where you hear kind of rumors of lawsuits because of the concert industry is trying to leverage them into putting out certain features or not including certain features.

So especially as a new start-up tech company involved in the media space, the threat of lawsuits these days unfortunately is something you've got to deal with. I think all these companies make their individual decisions about how they want to play that and what they need to do. Certainly even if you think you're going to be vindicated in court, there's a question of do you want to take on tens of millions of dollars in legal fees, and that's a tough issue.

Mr. Glazier: Or get a license, that's our option.

Mr. Petricone: Or not include certain features. There are plenty of options out there, and different companies do different things. The one thing I can tell you is that this not a particularly good thing for innovation. This is not a particularly good thing for venture capitalists. The last thing you want to do, if you're a venture capitalist, is invest in a lawsuit for obvious reasons.

At a time when we're worried about how we are going to innovate and compete with India and China or these countries that are building their entire tech industry to compete with us, for the innovation industry, that's not a healthy climate.

Mr. Ross: All right. I did want to open it up to all of you for questions. Why don't I see a show of hands for any questions here?

Sarah, in the back there.

Sarah Stirland, *National Journal's Technology Daily*: Mitch, I just had a quick question about the XM lawsuit. One of the claims in the lawsuit is that they're helping customers infringe. But if the customers have already paid and they know that the music is going to expire if they let their subscriptions expire, how can the court find them to have infringed? They're not the ones licensing the music; they're just buying a subscription.

Mr. Glazier: Right. What is so interesting is that the consumers are paying XM. They're not paying the creators. No money is going to the creators for their retention of the copy, which is part of the problem here. The lawsuit breaks down in different stages too. First, and most importantly, it alleges direct infringement. I want to be very clear about that. The allegation is that XM is a direct infringer, that they are offering the service, operating like a subscription service would and that their service includes the retention of a copy and that they are not compensating for that. My guess, as you're reading down claims and then getting down to, if not direct, then contributory.

The truth of the matter is that if a copy is being made without permission and without compensation, then there's infringement. That's the grand ruse that's being played on consumers here. They think that what they're doing is fine because XM is providing it for them and they're paying the subscription fee.

This is exactly what happened in the peer-to-peer context when Kazaa came out with a service that consumers paid \$9.95 or \$29.95 for, and a lot of consumers said, "Well, what's the problem? I'm paying for it!" There is an obligation for somebody providing a service to make sure that when they are providing consumers with the ability to do something, that that something be legal.

I would suggest that maybe those consumers aren't silly or negligent. Maybe those consumers read the law, specifically Title 17 of the U.S. Code and the Audio Home Recording Act, which says no action may be brought under this Title based on the non-

commercial use by a consumer of such a device or medium for making digital musical recordings or analog musical recordings. So maybe those consumers were silly and thought they were okay.

Mr. Ross: All right, any more questions? Oh, here we go, David.

David Carson, U.S. Copyright Office: Let's assume for the moment that this device, the XM device, is lawful under the Audio Home Recording Act. Michael has said in that case, we're compensating the performers and the copyright owners by paying the Audio Home Recording Act royalties. Just wondering, for each song that an end user reproduces on that device, how much in royalties is the copyright owner, the performer getting? Let's compare that, for example, to the royalties they might be getting from a download on iTunes.

Mr. Petricone: Thank you Congressman Murphy, let me address that.

[Laughter]

No, that's not the Congress. First of all, consumers aren't required to pay on a per-recording basis because that's fair use. However, Congress in its wisdom set up a system. That system is the Audio Home Recording Act. Since XM, like the radio stations, can't tell what or how often you're recording, they're not controlling the process. Congress knew that happened with digital transmissions, so what Congress said was, "We'll have a royalty of up to eight dollars per device, and that will be distributed to the recording industry, performers and songwriters." That's when they get compensated. So that's the structure that Congress set up.

Mr. Castle: Okay, so here's your answer. The total annual revenues that come in from the Audio Home Recording Act are about \$2 million for the year that's split between the record labels, music publishers, songwriters, recording artists and unions, okay. I think the number of downloads per day is almost two million.

Mr. Petricone: On these?

Mr. Castle: Downloads in the country. That's not even including the licenses on subscription agreements which are like those. So the revenue per year that is paid under the Audio Home Recording Act, which obviously was not meant to compensate for this type of activity, is about what would be made per day just in the download business not even including subscriptions.

Mr. Petricone: Yes, and there's a reason for that. This is the first mass-marketed product that's going to be. These products have been on the market for a couple of months, so at present, the royalties are minimal because the products have just gotten there. If these are successful products, we certainly hope that the royalties are going to be significant.

Mr. Glazier: I think it's...

Mr. Petricone: But again, it's based on what consumers do.

Mr. Glazier: It's capped, it's capped under the statute. It can't go up.

Mr. Ross: Okay it's capped. Dan?

Dan Horowitz, U.S. House Committee on Small Business: Can I ask a stupid question? You're talking about XM and Sirius having to pay additional royalties, is that what you're trying to say, Mitch? Is he saying that XM and Sirius -

Mr. Glazier: No, actually it's not XM and Sirius. I think it is Pioneer and Samsung who are paying. What Michael is talking about are Audio Home Recording Act royalties, and not XM and Sirius. But I believe they shuffled the tiny amount of money off on the commissioned consumer electronics guys who made the design that they commanded, and they pay under the Audio Home Recording Act. The question was, "Well, isn't that enough compensation so that we don't have to worry about going and getting licenses in marketplace?" My answer is absolutely not. A capped royalty from the two CD manufacturers is...

Mr. Horowitz: Right, so that being said, and under that, to draw a parallel, do you have that same parallel with Muzak and their equipment manufacturers?

Mr. Glazier: You mean do the equipment manufacturers from Muzak pay under the Audio Home Recording Act?

Mr. Horowitz: Yes, because I mean isn't that a satellite system or sorts?

Mr. Glazier: Doesn't Muzak have a specific exemption though because they're not enabling recording? I think Muzak is just a listening service. That listening service is covered as a pre-existing service under the license, and there was a special provision for them that was put in.

Mr. Horowitz: Okay, so there's a carve-out for them.

Mr. Glazier: It wasn't really a carve-out.

Mr. Horowitz: Do they pay a percentage of gross revenues? Is that right on something like that? They have their own rate structure, don't they? I can't remember.

Mr. Knife: They're one of the pre-existing services.

Mr. Glazier: Well, is he trying to trip me up?

Mr. Ross: Okay, any more questions? Okay, great. I want to thank everyone for

coming. I want to thank in particular Eileen Golding for booking the room, Marie Ryan for doing logistics and Amy Smorodin for letting everybody know about the event. And of course I want to thank our four panelists including George and Gracie down at the end. I don't know if they heard that. They're going to go all night, I think. Okay, thank you, everyone.

[Applause]

Speaker Biographies

Christian Castle practices law in Los Angeles, California, advising clients regarding traditional music industry transactions, technology transactions concerning content, and matters of public policy. His clients include Universal Records artist 10 Years, Hollywood Records, Cdigix, SNOCAP and legendary guitarist Jeff “Skunk” Baxter, as well as Grammy award winning producers Herbert Walth and Tony Maserati. He has been an Adjunct Professor at the University of Texas School of Law in Austin, Texas, where he serves on the board of the Austin Music Foundation. He continues to publish frequently, and is a Contributing Editor to *Entertainment Law & Finance*. Castle is a graduate of both the UCLA School of Law and the Anderson Graduate School of Management at UCLA, as well as a *magna cum laude* graduate of UCLA’s College of Liberal Arts.

Mitch Glazier is Executive Vice President, Government and Industry Relations to the Recording Industry Association of America (RIAA), the Washington D.C.-based trade association that represents hundreds of member record companies responsible for creating, manufacturing and distributing more than 90 percent of all legitimate sound recordings sold in the United States. Glazier serves as the chief advocate for the recorded music industry before policymakers and government officials and is responsible for industry relations, including the Gold and Platinum Sales Award Program. Glazier holds a Doctor of Jurisprudence degree from Vanderbilt University and a Bachelor of Science degree in Social Policy, cum laude, from Northwestern University. He is a member of the Bars of the State of Illinois and the District of Columbia.

Lee Knife is Digital Media Association’s General Counsel and Director of Business & Legal Affairs. In this capacity, Knife plays a key role in negotiations and arbitrations associated with sound recording and composition royalty rates in the United States and internationally. Knife joined DiMA in 2006 after a 15 year career in the recording industry in New York City. Prior to joining DiMA Knife served as a business and legal affairs executive for several record companies including EMI, BMG, the Sanctuary Group and Polygram. Knife has also provided consulting services to several internet-based, new-media companies. Prior to his work with record companies, Knife began his legal career as an associate attorney at several small law firms where he represented musical instrument manufacturers, individual artists, and small record and production companies. Knife is a graduate of St. John’s University and Brooklyn Law School.

Michael Petricone is the Vice President of Government Affairs for the Consumer Electronics Association (CEA). CEA represents more than 1000 U.S. manufacturers of audio, video, accessories, mobile electronics, communication, information and multimedia products that are sold, through consumer channels. CEA also sponsors and manages the International Consumer Electronics Show (CES), the world’s largest annual trade event showcasing consumer electronics products. In his position, Petricone has been responsible for representing the CE industry’s position before

Congress and the FCC on critical issues such as digital television broadband, privacy and home recording rights. Petricone is a frequent speaker on policy issues impacting the consumer electronics industry, and in 2003 he was featured by Dealer scope Magazine as one of the technology industry's "Top 40 Under 40". Petricone received his law degree from Georgetown University Law Center and his undergraduate degree from Tufts University.

Patrick Ross is Senior Fellow and Vice President of Communications and External Affairs. He also focuses on intellectual property issues for the Center for the Study of Digital Property. Ross spent the better part of twenty years as a journalist, the last decade covering the growth of the Internet and related regulatory policy. Before joining the Foundation, he managed *Washington Internet Daily* and wrote for *Communications Daily*. He also was the first Washington bureau chief for CNet News.com. A nine-time award winner for investigative journalism, Ross has appeared in publications such as *The New York Times*, *The New Republic*, *Red Herring*, and *Kiplinger's Personal Finance Magazine*, and he has been distributed by the Associated Press. He has been interviewed on C-SPAN, CNNfn, NPR and other media. He took a break from journalism in the late 1980s to work for Senator Harry Reid of Nevada. Ross received a B.A. in international relations from Pomona College and performed graduate study at Oxford University.