

Testimony of
Mr. Richard Parsons

March 14, 2002

Chairman Leahy, ranking member Hatch, and members of the Committee, it is a pleasure to appear before you today and have the opportunity to speak about such an important issue. As the world's first Internet powered media and entertainment company, AOL Time Warner ("AOLTW") is uniquely positioned to address the challenges and opportunities of the digital age. We have been a leader in developing digital technologies for delivering information and entertainment in new and innovative ways. Warner Bros. was the pioneer of DVD for video and Warner Music Group was the pioneer and first major record company to adopt the new DVD audio format. HBO was the first premium channel to offer nationwide high definition digital television. Time Warner cable has long been leading the way with digital video on demand. CNN.com offers a 24-hour news service over the Internet. And AOL is the world's leader in interactive services, Web brands, Internet technologies and e-commerce services with over 33 million subscribers.

At AOLTW, we live with competing business models and interests every day. But we are certain of one thing: Compelling content, be it Harry Potter or an interactive textbook, is what consumers want. Good content fuels the creation of new distribution businesses and the innovation of new products and equipment. And the continued availability of high-quality content depends in this digital age on the ability to protect that content from piracy. Therefore, as you begin examining these issues, I urge you to be guided by the fundamental principle that guides our own business decisions: strong and effective protection of intellectual property in both traditional and new environments is essential.

But this Committee knows that. You are experts on intellectual property protection, and through the Digital Millennium Copyright Act gave intellectual property owners important and balanced legal protections we rely upon as we innovate new digital business models. Digital technology offers significant benefits to content creators, distributors, and above all, consumers. It makes possible the delivery of higher quality in a wider range of formats and with greater reliability. Along with these benefits, however, it also poses substantial risks. Digital technology provides the ability to create quickly and easily an unlimited number of perfect copies, and allows for the global distribution of such copies with the click of a mouse. This obviously poses particularly damaging and challenging piracy risks. Our goal is both to stop piracy and to offer consumers what they want in terms of access to digital content. Before we get to the solutions, however, let me show you an example of the piracy we are facing - a high quality pirated version of Lord of the Rings that was available on the Internet while the movie was early in its theatrical release.

We know that most consumers want to see continued creativity and are willing to pay a fair price for content. Unfortunately, right now, with the advent of services like Napster and more recent peer-to-peer file swapping sites, a generation of young people is growing up thinking it's all right to steal. At an average cost of \$80 million per movie, that is simply not O.K.

Therefore, protection of content must apply pragmatically in the real world and not depend solely on legal remedies to be pursued in the courtroom. Instead, it must reflect a commitment by all contributors in the value chain to develop robust marketplace alternatives that protect content while enabling technological advancement. In order to achieve such effective protections, we have reached out and worked with our colleagues in the information technology (IT) and consumer electronics (CE) industries over the past six years to develop various content protection technologies. We are far from done, but we have come a long way and are hard at work to meet the new challenges before us.

I am pleased that sitting beside me today is Craig Barrett, from Intel. Intel has been one of the most dedicated and productive partners in the quest for protecting content in the digital environment. Indeed, Intel, along with other IT and CE companies, has spent considerable resources developing a number of technical solutions. We at AOLTW have enthusiastically embraced these solutions and we thank Intel for its past efforts and look forward to continuing to work together.

Here's an idea of how much we have accomplished so far through collaborative industry work: an encryption system to protect DVD video, a technology to protect content passed through device-to-device connections in home networks, a technology to protect content as it moves from computers to display on a monitor, a technology to protect DVD audio, and a technology for making recordings for home use that inhibit the potential for digital piracy.

The cornerstone of these cross industry efforts has been the following principle: to the greatest extent possible, copyrighted content delivered digitally should be protected with access control technologies, such as encryption, from the first point of distribution. Because the content is scrambled, only those devices and services that have the authorized keys may unlock it. To receive the keys, such devices and services must follow conditions regarding proper handling and usage of the content. These conditions are negotiated among technology providers, content owners and device manufacturers in license agreements, through a market-driven and voluntary process. Enterprising companies develop the technologies and the licenses are negotiated in private-sector negotiations. Content owners may choose whether or not to use any of the technologies, and product manufacturers are free to choose which, if any, of these access control measures they wish to enable on their devices in order to receive encrypted content.

The technologies already developed and implemented by these private sector efforts have made possible new and attractive formats for delivering content to consumers. The DVD format stands out as a primary example. Consumers have enthusiastically embraced it and have adopted DVD much more quickly than any past format, including CDs for music and VHS for video.

Some have asserted that content owners will use these new digital protection technologies to lock our content in some type of "lock box," denying many consumers the ability to view or enjoy it. This is simply illogical. Our businesses thrive upon building as wide an audience as possible for our works. Others have hypothesized that the new content protection technologies will overreach and deny consumers any ability to make home copies. Again, they're wrong. Keeping customers satisfied just makes good business sense. We want those who purchase our content to have the ability to enjoy that content in a flexible and portable way in their homes. In fact, under the content protection licenses negotiated to date, consumers will not only be able to continue analog

home copying, but also to make protected digital copies of over the air broadcast, basic cable and satellite and paid television such as HBO.

We are proud to have made the strides we have to date. So, having made a good deal of progress in our cross-industry content protection efforts, what do we see as government's role? Simply put, it is filling the gaps. We are not calling for a broad government mandate of design requirements across the spectrum of products, devices and services.

Instead, it has become clear that certain significant gaps exist that we cannot solve through license-based, voluntary protection systems since it is impossible to require all manufacturers to join the effort. These gaps occur when content is either initially delivered without access controls (i.e. "in the clear"), or later converted into unprotected formats. Let me explain the first of these gaps: over the air broadcasts are delivered in the clear, with no access control. Therefore, there is no way to ensure through private sector technology licenses or any other contractual means that all devices which receive such content protect it against unauthorized digital reproduction and distribution.

Significant work has been undertaken by industry to develop a method for identifying copyrighted broadcasts with a "broadcast flag" that accompanies the signal to indicate that the content should not be redistributed over the Internet. In order to ensure that devices that receive the broadcast signal obey the flag, there must be a legal requirement to detect and respond to it. We believe that such a requirement can be accomplished by narrowly focused government action. It appears that our partners in the CE and IT industries agree that this targeted government action is both necessary and desirable.

An even more critical and systemic problem is what we call the "analog hole." Video content, even when delivered digitally in a protected manner, must be converted to an unprotected analog format to be viewed on the millions of analog television sets in consumer homes. Once content is "in the clear" in analog form, it can be converted back into a digital format which can then be subject to widespread unauthorized copying and redistribution, including over the Internet. This problem applies to all delivery means for audiovisual content, from DVDs to pay per view, to over the air broadcasts.

One way to plug the analog hole is through the use of watermarks. A watermark is a way of embedding information in the content about its copyright status and permitted uses. The watermark is not perceptible to the consumer, but can be detected by devices. Furthermore, because the watermark is embedded, it is securely tied to the content and survives digital to analog to digital conversions. If devices that are capable of converting analog signals into digital form are designed and manufactured to detect and respond to the watermark, then the content can be appropriately protected.

As with the broadcast flag, private industry efforts are underway to develop and select a consensus watermark. These efforts have been hampered, however, by patent disputes involving various parties that own watermark related intellectual property. Because a single watermark must be agreed upon, if private industry selection efforts fail, we are likely to turn to the government for guidance and assistance. Once a watermark is selected, some government action will be needed to require appropriate detection of and response to the watermark. In our view,

effective government action can be narrowly focused on the particular devices or portions of devices that are capable of receiving an analog signal and converting it into digital. No broad mandate concerning the overall design of computers or consumer electronic devices is necessary.

Now let me turn to an additional serious problem that remains to be addressed. The unauthorized multiple reproduction and redistribution of copyrighted content over peer to peer services and networks (including over the Internet and over broadband networks on college and university campuses) is rampant and exponentially growing. The popular term "file sharing" is a misnomer; this activity is equivalent to online shoplifting, in fact it's worse than shoplifting because it doesn't simply involve taking a copy for oneself, but distributing multiple copies throughout the world to others.

AOLTW, along with the rest of the content industries, has pursued its legal remedies in a number of cases, most notably the Napster litigation. However, the pace of illegal peer-to-peer activity has grown considerably. A host of new peer-to-peer services, such as KazAA, Morpheus and Grokster, have flourished on the Internet. Studies have shown that at a given moment 500,000 to 1 million users are simultaneously making use of these services and networks to find, reproduce and redistribute files. If the past activity on Napster serves as any guide, approximately 90% of the activity on these services consist of unauthorized trafficking in copyrighted works.

To date, the music industry has experienced the most dramatic impact from this digital piracy because sound recording files are much smaller and easier to copy and redistribute than are files of motion pictures and television programs. Record and CD sales were down 10% last year. In 2000, the top ten albums sold a total of 60 million units; in 2001 they sold 40 million units. And in 2000, 7 albums sold over 5 million units, whereas in 2001 none did. Because the world's largest music publisher, Warner/Chappell, as well as one of the five major record companies, Warner Music Group, are part of the AOL Time Warner family of companies, we are deeply concerned about the effects of peer to peer piracy on music.

Advances in broadband and compression technologies mean that audiovisual works will soon be subject to such severe levels of online piracy, and that piracy of music will become even more extreme, unless this serious problem is brought under control. The Lord of the Rings clip I showed you earlier was downloaded from a peer to peer service.

Solving this problem is the most complicated we have experienced to date. One contributing factor is the growing variety of increasingly decentralized peer to peer networks (e.g., Morpheus, Limewire, etc). Another is that content reaches peer to peer networks from a variety of sources including unprotected distribution (e.g. "ripping" from CDs), circumvention of protected content, and camcording from theater screens. No single silver bullet--technical, legal, legislative, or business--can provide a solution to this thorny form of piracy. The active co-operation and committed participation of all industry sectors--content, consumer electronics, computer, and service provider--will be necessary to develop a range of solutions. Accordingly, content owners will need to share in the responsibility of finding the sources of unauthorized distribution. We do not yet know what type of government measures may be called for, but some assistance will likely prove necessary to supplement private sector efforts to bring this piracy under control and to create a more secure environment for content delivery.

In conclusion, while the issues are complex, we believe that the lead must come from the private sector, complemented where needed by targeted government action. I believe that others share this vision, and hope that we can work together cooperatively with each other and with Congress to make it a reality.