

Testimony of
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STATEMENT OF CARY SHERMAN
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SENATE COMMITTEE ON THE JUDICIARY
ON
PROTECTING COPYRIGHT AND INNOVATION
IN A POST-GROKSTER WORLD
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Mr. Chairman, Senator Leahy, and Members of the Committee, I appreciate the opportunity to testify today on the Supreme Court's Grokster decision and its implications for copyright and innovation in the coming years. Clearly, the decision in Grokster was a defining moment for distribution of music and other creative content in the digital age. The Court, in a rare unanimous decision,

recognized that those who actively induce or encourage others to steal copyrighted works may be held liable themselves for the resulting infringement. The language of the opinion may be legalese to many, but the message was simple: theft, in any medium, is unacceptable, and those who facilitate it may be held responsible. The music industry has been hit particularly hard by the massive theft occurring on illicit peer-to-peer ("P2P") file-sharing networks like Grokster. These networks have

allowed computer users to illegally copy and distribute millions of songs, movies, software, and other creative works for free. As former Solicitor General Theodore B.

Olson said, this is "the greatest ongoing theft of intellectual property that the world has ever seen." And the negative impact of this theft on legitimate sales has been substantial. In 1999, the value of unit shipments reached nearly 15 billion dollars. By 2004, that figure had plummeted to around 12 billion dollars. SoundScan has reported that, through the week of September 4th of this year, album sales are down 8.5% versus the same period for 2004.

Record companies are essentially venture capitalists, investing in human beings who create music, in the hope that they will create music that people will want to hear, and buy. The revenue we earn from the sale of recorded music is ploughed back into new music and new artists. It's a risky business, with only about a 10% success rate. Yet, releases from the most popular artists (which make up most of that successful 10%) are often the ones most heavily pirated on illegal file-sharing networks. According to Soundscan, the top 10 albums sold 54.7 million units in 1999, compared to 37.4 million units in 2004, a drop of 32%. The top 100 albums sold 194.9 million units in 1999,

compared to 153.3 million units in 2004, a decline of 21%. The result is less money to invest in new artists and new music.

Numerous studies by academics have confirmed that illegal file-sharing has had a direct negative effect on music industry sales. And we're not the only ones. Motion pictures, software, video games - all are impacted. The U.S. economy and the industries that employ over five million Americans and account for over 6% of the nation's GDP have all been hit by illegal file-sharing.

Of course, these numbers don't fully capture the personal toll exacted by this illegal activity. Composers, artists, musicians, technicians, and a multitude of others engaged in the music, film, and other entertainment industries have seen their jobs disappear. Thousands of music stores across the country have had to close their doors. Left unchecked, the networks that promoted this illicit activity threatened to instill in an

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entire generation a culture of lawlessness and a complete lack of respect for copyright and the valuable works it protects.

The decision in *Grokster* helps to change all that. The Court overturned two lower court rulings to recognize that companies, like *Grokster*, that provide the tools and promote online infringement must be held accountable. It clarified that inducing and encouraging infringement are just as much a part of copyright law as the doctrines of contributory infringement and vicarious liability. This result is completely consistent with the landmark *Sony Betamax* case which, the Court noted, "was never meant to foreclose rules of fault-based liability derived from the common law."

In fact, the *Grokster* decision does nothing to change the holding in *Sony Betamax*. Rather, it shows that the Ninth Circuit's interpretation of the case--which, among other things, required knowledge of each and every infringement at the time of the violation as well as the ability to prevent the infringement at that time--was wrong. Simply, courts are not required to "ignore evidence of intent if there is such evidence...." And there was plenty of evidence of what *Grokster* intended. As the Court noted, "the unlawful objective is unmistakable." Without giving away our property and the property of thousands of others for free, and thereby earning revenue from spyware and advertising aimed at those looking to steal, services like *Grokster* would go broke. A business model predicated on theft is unacceptable. The Supreme Court injected into copyright law some common sense, based on centuries of common law.

The Court was also careful to balance the interests of content innovators and technology innovators, noting that their ruling in *Grokster* "does nothing to compromise legitimate commerce or discourage innovation having a lawful purpose." By focusing on

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the behavior of *Grokster* and similar companies, and not the technology they used, the Court separated the good actors from the bad actors, and left intact the *Sony Betamax* standard that has served creators, technology developers, and consumers so well.

It is not surprising, therefore, that the Court's decision in *Grokster* has generated such widespread praise, from companies and opinion leaders across the business and ideological spectrum. Editorials in the *New York Times* and the *Wall Street Journal*, the *Washington Times* and the *Washington Post*, the *LA Times* and the *San Jose Mercury News*, have uniformly congratulated the Court on its carefully balanced, unanimous decision.

Grokster has sent a clear message to those businesses that continue to actively facilitate infringement: It's time to go legit. The clarity provided by the Court, rather than stifle innovation, will increase it. Venture capital will flow to technology companies that respect property and reward the future of music. Companies like iMesh, Snocap, Mashboxx, Passalong, and Wurld Media, as well as new technologies that operate within the law, will have a chance to gain traction, attract investors, and appeal to fans. Within days of the decision, venture capital firms were calling legitimate companies offering licensed P2P services, looking for opportunities to invest. And as the clear message of the Supreme Court's ruling has sunk in, more and more of the illicit P2P companies have looked for ways to go legit, to pay creators, to offer consumers an even better musical experience.

The Grokster decision ensures the healthy growth of a legitimate market eagerly seeking support. Apple's iTunes, Real Networks' Rhapsody, Napster, Ruckus, Cdigix, Walmart, Yahoo, and many others have worked hard to build successful destinations for

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legitimate online music. In March 2005, 26 million songs were purchased from digital music stores in the United States.¹ Forty-three percent of music downloaders in 2005 have tried legitimate online music services² and 34% of current music downloaders say they now use paid services.³ For 2005 (through week of September 4th), 217.4 million digital tracks have been sold, versus only 78.6 million sold for the same period in 2004. The growing interest in these services can be clearly seen on the campuses of colleges and universities across the country. Nearly 70 schools now have deals with a legitimate service, a more than threefold increase from just last year. The decision in Grokster has played a major role in this growing trend, focusing attention on the issue of illegal filesharing and providing school administrators with undeniable moral and legal clarity.

In fact, it has provided everyone with clarity. Those who make the music, movies, software, and other creative content we love now know that their hard work will be protected. Consumers can now look forward to more of these great works and know that they can get them in a safe, secure, respectful, and legal way. Those who seek to bring us content in fresh and innovative ways on new and old distribution platforms now know that they don't have to compete with illicit free-riders offering the same content for free. Those who seek to support these exciting new legitimate products and services can now have renewed faith in their investment. And those who choose to continue their businesses with a model based on theft now know that there is no excuse. The time to go legit is now.

1 NPD MusicWatch Digital Service.

2 Pew Internet and American Life study, March 2005.

3 Pew, March 2005.

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We know that a judicial decision, even a decision of the U.S. Supreme Court, is not a magic bullet. It won't automatically eliminate piracy or improve sales. But the Court has laid down a legal and cultural marker. Those who don't play by the rules now know that it is not acceptable to reap ill-gotten gains while burying their head in the sand. And the absurd notion that, somehow, it's okay to take someone else's property just because you can, has been shown to be precisely that - absurd.

The Grokster decision gives us the chance to compete in a legitimate marketplace,

to earn a return on our investment, to continue offering great music for fans everywhere. We look forward to making our music available in a myriad of new and exciting ways in the years to come.

Thank you.