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Transcript—Artist Relations—The Current State of Affairs and Emerging Models for Songwriter and Recording Artist Relations in Connection with Digital Exploitation of Music

TRANSCRIPT
ARTIST RELATIONS—THE CURRENT STATE OF AFFAIRS AND EMERGING MODELS FOR SONGWRITER AND RECORDING ARTIST RELATIONS IN CONNECTION WITH DIGITAL EXPLOITATION OF MUSIC

Jay Dougherty, Moderator[*]
Jay Cooper, Panelist[**]
Dean Kay, Panelist[***]
Robert H. Kohn, Panelist[****]
Mark Goldstein, Panelist[*****]

JAY DOUGHERTY: The purpose of this panel is to discuss contractual relations between the artist—and their publishing companies and record companies. I'd like our panelists to address how past publishing and recording artist agreements address grants of rights and sharing of revenue from these emerging uses of their music, how traditional publishing and recording artist deals may be changing to reflect the increasingly important question of rights and royalties from digital exploitation, and what kinds of deals digital distribution companies are making with copyright owners.

As to the new digital distributors, Bob Kohn is here with a slightly different hat on in this panel, which is talking about the kinds of deals that companies like Emusic are making with recording artists for the digital distribution of their recordings. On the traditional recording artist agreements, we have Mark Goldstein from Warner Brothers Records, and I'm hoping to get him to talk about how old recording artist contracts address digital rights and payment for digital exploitation of recordings and what they're doing to address the changing digital distribution. We have

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Dean Kay from the publisher's side to talk about how publishers are addressing the digital distribution of music through digital phonorecord delivery and streaming, and we have Jay Cooper, the lonely artist representative, to represent the artist point of view in all of this and talk about what the deal should look like from the artist point of view, and hopefully we'll have some time for some interplay amongst all of these different interests to talk about, whether the record companies have these rights, and how should they be paying for them under their existing contracts and under contracts on an ongoing basis.

We should start out with what I hope is perhaps the simplest of these issues, and Dean, that would bring us to your situation. We have a provision from a standard songwriter contract in your materials, and I wanted to start off with Dean addressing songwriter agreements. Do they address digital distribution of music and payments for the digital distribution of music, and if so, what's the deal?

DEAN KAY: Well, I think the all-encompassing provisions in most songwriter contracts do address what's happening out on the Internet. I think we're all trying to figure out exactly what is going to be going on out there, but there are provisions that say that publishers must pay 50% of any new technologies or any new items that come online, and a lot of publishers are dealing with it that way. We've indicated that the Internet rights belong to us in our agreements. Some go a little farther. Some are more extensive. One thing that I do want to bring up here is that the last people that are thought about by the people in the technical area are the people that make this industry operate, and that's the songwriters, and specifically, independent songwriters who can't go out and sell T-shirts or do concert dates to take up what might be lost from pirating.

JAY DOUGHERTY: I like my Marilyn Bergman T-shirt.

DEAN KAY: Yes, but she'd like to get paid, you know. Somebody else is making money on your Marilyn Bergman T-shirt.

JAY COOPER: Except that a lot of old songwriting contracts, and there's a lot of them around, say that unless it's specifically set forth herein, the publisher will pay you no additional royalties, and if the publisher chooses to do so under many of those contracts that are existing, and they're out there all over the place, then the poor songwriter may not be getting anything on this new technology because the contract didn't specifically provide for it.

DEAN KAY: Well, that's possible; that option does exist, and I agree with Jay on that. However, having run major music publishing companies in the past, I know that we've always taken a look at . . . I've run companies that have had contracts dating back to the early 1900s, and we've always tried to adjust our royalty payments and our considerations to what was going on during the particular period in time. So I know, personally, I've never dealt with songwriters that way, but perhaps, there have been a few that have.

JAY COOPER: There are a lot.

BOB KOHN: Jay, even though the songwriter contract may not have that catch-all 50% clause, everything that I'm paying from Goodnoise to the songwriter side, the music publishing side, is either a mechanical or a performance. So since those terms are covered by the songwriter contract, I don't think that's going to be a major issue unless the artist, unless the songwriter is not entitled to mechanicals.

MARK GOLDSTEIN: Well, it depends. Yeah, if there's a writer's share and they're getting a writer's share and that's the payment, that's fine. But if it's going to a publisher and the publisher has a contract like Jay's talking about, and he doesn't feel he has to pay the writer, then it is a problem for the writer.

JAY DOUGHERTY: I think one problem in this area is, unlike typical licensing deals, publishing deals have been copyright assignments for a long time, and therefore, there may be more of a question about whether a record company has the right to distribute in a digital medium. I know there was that problem with regard to CDs. But in a copyright assignment agreement like your typical songwriter agreement, it's harder for the artist, the songwriter, to make an argument that she didn't grant those rights, and yet the contract may not provide for payment. Jay, is that what you're referring to?

JAY COOPER: Yes, there are a lot of these contracts around in which it says, "unless the royalties are specifically set forth herein," in regard to certain categories, that then will not pay you any other royalties. It specifically says that. A lot of these contracts. Not all contracts are with Warner Brothers. Not all contracts are with BMG or MCA. There's thousands of contracts with small little companies, and I've seen that provision over and over again, and yes, if they choose to do so, and many companies have chosen to do so, they don't pay royalties unless it falls into a narrowly defined category.

JAY DOUGHERTY: Is there anything an artist can do about that other than try to force a renegotiation on sort of a personal level or something?

JAY COOPER: Well, there's all kinds of lawsuits that are filed under various and sundry theories, but most artists don't have the money or the wherewithal to support that kind of litigation.

DEAN KAY: Yeah, I remember Little Richard, marching up and down on Sunset Boulevard with a placard saying, "Pay me."

MARK GOLDSTEIN: Well, and the fact is, as Jay says, I mean, it costs money to fight those suits and especially the technology like this where it's still more potential than reality. There's just not enough at stake to justify one of these guys going after that, so you get in a place where it's after the fact and you gotta establish what the money was. Those are difficult battles to fight. I mean, it happened on the record side, you know, back in the R&B days, and then there are still people who are grievously underpaid.

JAY COOPER: That's true. I have a former client by the name of Phil Specter who was a great, great producer around, and he walked around forever . . . he probably still does today . . . with a big button on his lapel that said, "Back to Mono." (audience laughter) That's probably a good idea. Look at all the trouble we're in today. We can't figure it out.

DEAN KAY: Some of the stuff coming over the Internet sounds like mono.

JAY DOUGHERTY: So I guess that's a snapshot of the publishing situation that many right-minded publishers provide for sharing of revenues in this situation, but there are other older songwriter contracts that involve what's arguably a grant of rights for the digital medium, but do not provide for payment. Obviously, a problem from the songwriter's point of view.

BOB KOHN: I don't see that as an issue, I really don't. I can't think of what it could be besides a performance royalty or a mechanical royalty. If it's a mechanical royalty, the artist . . . well, they generally get paid cause it says so in the songwriter contract. If it's a performance royalty, the artist doesn't get 50% of the publisher's. . . of the performance unless they have a publisher's interest, in which case they would get it. So, I don't get the issue.

MARK GOLDSTEIN: No, again, I think, sure, if it's performance, there's a writer's share that gets paid directly. If it's mechanical, though, it's going to go to the publisher, and if the publisher has a deal with the writer, that . . . and again, it depends on how the contract deals with use . . .

BOB KOHN: Have you ever seen a songwriter contract that does not provide a share of mechanicals to the songwriter?

MARK GOLDSTEIN: I've seen it defined as . . . defined mechanicals, defined not necessarily with reference to what the copyright act says, but mechanicals on vinyl discs or on discs, and that's a different thing.

BOB KOHN: Gotcha.

JAY DOUGHERTY: So if there's a narrower definition of what mechanical royalties the songwriter shares in, rather than the whole universe in any form now or hereafter known, then the songwriter would have a problem.

MARK GOLDSTEIN: That's right.

JAY COOPER: Many contracts have a physical delivery description.

MARK GOLDSTEIN: Precisely.

JAY COOPER: And today, where you can now make a distribution that is not a physical distribution, not a distribution of a physical item, then that's where the problem lies.

BOB KOHN: I would hope that there isn't any existing music publisher today who would take that position with a songwriter.

MARK GOLDSTEIN: I'm actually not aware that there is, but Jay would know more about it than I do.

DEAN KAY: I'm hoping not too.

JAY DOUGHERTY: Jay, have you actually had any situations where a songwriter has not been paid a share from digital phonorecord delivery? Or is DPD is too new for there to be any money involved for this to have come up.

JAY COOPER: It's very new. We're dealing in streaming technology, we're dealing in downloading, and it's very new, and there's not much knowledge yet by anybody in this area, but we're looking at those contracts, we're re-examining those contracts every day and everybody at Warner Brothers and everybody else are changing their contracts now to cover these future areas, and the reason they're covering these future areas, is because everybody believes that they weren't sufficiently covered under the current contract.

JAY DOUGHERTY: Okay. Let's move on to the recording artist context, and we'll take questions at the end, I think. In looking at similar questions on the recording artist side, maybe Mark, you could address initially older contracts prior to this incredibly quickly blossoming digital distribution era. Do they grant rights for this kind of distribution? Do they cover the digital performances of the sound recordings themselves? Are the performances monies shared in some way with the artist? Are the artists paid royalties for the digital phonorecord deliveries under the older contracts?

MARK GOLDSTEIN: Well, a lot of questions and no easy way to answer except to say that there are old contracts and there are old contracts and every contract's a different contract. If you go back far enough, you got a lot of contracts, not necessarily at Warner Brothers, but there are other companies that have words like disc or vinyl disc, and that's not the only thing that they pay royalties on. In some of those contracts, that's the only rights the record company has, which means that the company, if they're going to exploit stuff in a nonphysical, non-discrete medium, may rightfully or not, believe that they have to go back and get additional rights. Those are pretty old contracts. I think pretty much by the time you get to the early 60s, most of that kind of language, it disappeared and people were throwing in the "technology, whether now known or hereafter developed" kind of language, and that pretty much gets there.

There's a group of contracts, maybe from the 1960's to possibly the early 1970's, depending on what record label was doing the deals and whether it was a small independent or a major company, where it's very clear that the record company owns rights in the material that's delivered in any and all media, any and all configurations and . . . says perpetuity, but obviously, we're talking life of the copyright there. And at the same time, those contracts only provide for payment of royalties with respect to certain specified kinds of uses that, generally speaking, don't extend to uses that don't involve a discrete physical item changing hands. Some of those contracts have the "anything not described herein," you get 50% of net, but a lot of them don't. And a lot of those situations, I think a record company would, at least on the strictly contractual side, be justified in taking the position that they can exploit these things, and they theoretically would not have to pay any kind of royalty to the artist for those things. That's putting aside statutory issues, and it's putting aside continuing relationship issues and things like that. I can't speak for other companies; in fact, I can't even speak for Warner Brothers because we haven't really had to deal with that issue. We don't have contracts like that. Anything from pretty much the early to mid-1970's on, *generally*, again covers all media, all new configurations, and it also provided in almost every case, for payment with respect to exploitations of the material that's delivered, and exploitation is generally defined broadly enough to include monies or other consideration that the record company receives from the exploitation of the recorded material, and that would not necessarily require a hard, fixed device changing hands.

In that case, you gotta look and see what the royalty rate is. In a lot of cases, and probably in the majority of the cases or contracts before, say, the mid-1990's, or maybe even the late 1980's, would refer to 50% of net receipts again. We started putting in our contracts at Warner Brothers, sometime in the late 1980's, language that talked about direct transmission and other kinds of things, and we talked about it being the same pennies as what we would pay, and in those days we would specify tape as being the rate and in most record contracts the rate for vinyl and tape and CD is different. The pennies tended to be less for tape than it did for the other two, so that's why we chose it. That gets negotiated a lot and it's all over the place in contracts, but by and large, with any recent contract or any recently renegotiated contract (and a lot of times the renegotiations go back and affect previously existing contracts), the record companies now are paying something that is based in one way or another on the pennies that's paid for existing technologies, whether it's cassette or whether it's CD. It may not be 100%, just like in a lot of contracts today, the rate for CDs isn't a 100% of what the royalty rate is that's listed in the royalty paragraph.

JAY DOUGHERTY: The rate or the pennies?

MARK GOLDSTEIN: The rate. Again, and I tell this to everybody when you're dealing in general with recording contracts . . . forget even this issue. Recording contracts always talk about royalty rates, and I think these days pretty much every company does . . . Capitol for a while used to have pennies in their contracts, but everyone likes percentages. Do the math. Figure out what the pennies work out to be, but the best you're going to get, if you're negotiating without massive artist clout, is that the pennies are going to be the same as on a CD. Now, you get artists that come in and say, "Wait a minute, you're not manufacturing anything, you're not doing packaging, you don't have to store the stuff, you don't have returns to worry about, how can you possibly pay us just in pennies?" Those are all wonderful arguments, and my take on that is that, as long as record companies can make the kind of deals they're making and make more profit, they'll continue to do it. At some point the marketplace, and when I say marketplace, I mean, the record company's competition with each other to sign they artist they want, is going to lead to some kind of accommodation there, but for the moment, I think it's fair to say that, with the exception of the artists with the greatest amount of bargaining power, record companies are still pretty much basing what's going to be paid for these kinds of transfers on what is being paid with respect to physical transfers. Again, I know that I don't have to say this but, just to make the distinction clear for everybody out there, what we're talking about here is a transmission of the recorded material, not somebody just going to, say, Amazon.com and ordering a CD that gets mailed to him. The CD that gets mailed to him, that gets handled for royalty purposes the same as any other transaction. It's like if you bought it at Tower Records, or if you bought it at the mom-and-pop store down the street.

JAY DOUGHERTY: So that's a normal retail channel?

MARK GOLDSTEIN: That's right, yes.

JAY COOPER: In answer to that, a couple things. One, the average over-reaching controlled composition clause of every record contract contains a provision that says we will only pay you publishing on the same records for which we pay you record royalties. There's a lot of categories of records in which they don't pay any royalties, and one category in many of these contracts, is the category of the new media. If it's not specifically set forth—if it's not an LP, if it's not a cassette, if it's not a CD, if it's not another defined technology—then they don't pay you royalties in many instances, which means, also, in regard to your publishing, you're not going to get paid on much of the new media.

MARK GOLDSTEIN: Well, let's clarify it. The publisher will get paid. It's just that payment, if the contract has a controlled composition clause like that, will get charged against the artist as additional advance.

JAY COOPER: It will get charged against the artist royalty, so it's deducted . . . pursuant to the controlled composition clause. They won't pay it. Then, the next thing is, with the new digital medium here, what we have to worry about is the new business dealings. The record company now goes ahead and goes into business for themselves as a retailer, which I think is coming. It looks like it's rapidly coming. If they sell directly online by *downloading* . . . I'm talking about downloading now, without a physical product, what the record companies will be attempting to do is get the best of all possible worlds. One is, Mark is right—there's no packaging—but they're still going to take a packaging deduction. There are no free goods, but they're still going to take free goods, even though they're not distributing. There's no warehousing or anything else of that nature. Yet, they are still going to take those deductions. In addition to that, they are going to get a higher price. Presently they're wholesaling a record now for about \$10.70, \$11.00 or something in that vicinity. If they're going to sell direct, they're not going to sell at a wholesale price to the consumer; they're going to sell at a retail price. So they're going to get another approximate 40% boost on wholesale, of which the artist will not participate in at all.

MARK GOLDSTEIN: Well, we might sell at that; we might not. I mean . . .

JAY COOPER: You might.

MARK GOLDSTEIN: I mean, the consumer might decide that if they're not getting a hard piece of product and packaging, they want to pay less. I mean, we don't know yet.

JAY COOPER: We don't know but, as attorneys in negotiating record contracts, you have to worry about this. You have to protect your artists in regard to this because all of a sudden they'll be now a substantial additional amount of money that's going to the record companies that the artist is not sharing in. And also what the record companies are also trying to do now is to give you a reduced rate for new media product, so they're going to give you a reduced rate on the price that they sell to that consumer. They pay you on 85% because of free goods, and they reduce the price by another 25% because of packaging, and they reduce it by another 25% if it's a CD, or they reduce that by another 25% because it's new technology. What a terrific deal.

AUDIENCE MEMBER: And don't forget reserves.

JAY COOPER: And don't forget reserves. (audience laughter)

BOB KOHN: Jay, I . . .

AUDIENCE MEMBER: Are you saying that the record labels are asking for all that and the attorneys and artists are still flopping on that?

JAY COOPER: It's all up in the air at this particular point. It's going to be a major war. Absolutely.

BOB KOHN: Jay, let me ask you a question. Make some assumptions that . . . indulge me for just a moment. My company's got a \$400-\$500 million market cap today. We've raised \$30 million, and let's assume, just indulge me, that I raise another \$100 million by the end of this year. Let's assume that four years from now—indulge me—50% of music revenues come from downloading files off the Internet and let's forget about whether it's encrypted or not. Let's assume now that I go to the artist like I have been doing, like They Might Be Giants, or Poster Children, or through independent record labels, and I offer them . . . I sell the song for 99 cents a track. I take a nickel off the top. It actually costs me less to do the transaction through the credit card company. I always pay the full statutory rate. It's our company policy. We will never ask for a rate, so take 7.1 cents or 8 cents off the top. . .

JAY COOPER: What kind of company is it?

DEAN KAY: That's my royalty. (audience laughter)

BOB KOHN: Take another 10 cents that I have to pay Yahoo and AOL and the others for referring people to my site, cause I'm going to pay them a referral fee like Amazon.com program. And I got like about 70 cents left, conservatively, all right. And suppose I offer the artist, like I am doing today, 35 cents a track or about 3.50 an album. Would you advise your client to sign up with me or with Warner Brothers?

JAY COOPER: Well, if you can market it, I'd advise them to sign with you.

BOB KOHN: Okay.

JAY COOPER: Because remember that, one of the reasons . . . one of the remaining reasons for signing with record companies today . . . one of the *remaining* reasons, by reason of the fact that you can get your product out there by yourself now' is marketing. Marketing, okay. You need, right now, a record company to market; however, there are people out there now going into the marketing business who were from record companies who say, "I will market your records." They're talking to all of these new artists.

BOB KOHN: And I can go to those companies, as well, and hire them.

AUDIENCE MEMBER: Are you paying an advance?

BOB KOHN: I'm paying very big advance. I got $15 million to pay advances with.

MARK GOLDSTEIN: And that's my point. At some point. . .

BOB KOHN: And stock options. (audience laughter)

MARK GOLDSTEIN: And he's got .com after his name, so assume what?

BOB KOHN: Assume I have a $4 billion market cap for four years.

JAY COOPER: Yeah, I mean, the record business . . . the record business is changing. It's changing *dramatically*. We don't know where it's going, and we don't know who's going to survive. We're in the throes of a great revolution right now, very fascinating and interesting revolution, and the only thing I caution . . . because I represent a lot of artists, the only thing I caution is that we have to protect the artist in this new technology. We have to protect their bottom line and what they're going to get out of this. The record companies can't exist without music, they don't create music, I don't know what president of any company that you know, *creates* any music.

MARK GOLDSTEIN: Well, there's something else to consider there, and I think it's worth raising this issue now even though it's not a strictly legal issue. What Bob is saying is absolutely right. It's the point I was making before, which is, yeah, record companies are getting away with the kind of deals I was talking about, but that works only as long as competitively record companies are able to do it. When enough artists that A&R people at the record company want to sign end up signing with Bob because Bob offers a better deal, I assure you, the record companies that want to survive are going to change their ways, or they're not going to survive. Now, at least they're not going to survive as entities selling, marketing and making money from newly recorded music, and that's the issue, you know.

BOB KOHN: Can I put that in an ad, by the way, that last statement that you just said. (audience laughter)

MARK GOLDSTEIN: Fine with me. Again, actually, I should have said this before I stated. Unless I say, specifically, to the contrary, every statement I'm making is a statement on behalf of Mark Goldstein, the individual, not on behalf of Warner Brothers Records, the record industry as a whole, RIAA member companies, or anybody else. I mean, Bob and I can sit here and talk. But the fact is, record companies may very well decide to go any number of ways. They're all parts of big multi-national corporations now that make most of their money from other kinds of activities, and I would not be surprised if some of those companies decide that the business they want to be in is exploiting the catalog they've already got. Why would they want to be in the crap shoot business trying to develop new stuff? They'll let Bob Kohn do that. And companies have, some companies have, massive assets in that area.

Now, that gets to the issue of whether all the assets that are out there are running around naked because you've got CDs of that stuff, and they're not protected, and there are people at record companies and their parent companies who are sitting there figuring out ways to market some new technology that theoretically will sound a whole lot better and everyone will want it, and then it will be encrypted. I think it's not going to work very well, but that's . . . that is the way that that issue's being addressed, and I think we have to bear in mind that it is at the end of the day going to be a marketplace-defined issue, and the marketplace just isn't consumers buying recorded music. The marketplace is whether record companies can be acquiring the new assets they want to acquire, and if, in fact, people like Bob can offer better deals, and that's how the marketplace develops, you will find the major record companies changing the way they do business. They'll have to, to survive.

JAY COOPER: Well, also artists today are looking for new means to distribute their product and get a bigger piece of the action, and if somebody promises them a bigger piece of the action, and they're convinced that they not only get a bigger piece of the action but there is actually action . . . (audience laughter) they'll go with that direction. So some artists are trying it themselves, a la Annie de Franco. Some artists will look at Bob's company Goodnoise. Some artists are in the business of now taking subscriptions for their music. They get a fee, a monthly fee, and then they record some tracks and send it out over the Internet to the "subscribers." Everybody's looking for new methods here. Artists have been unhappy for a long time that they're not getting enough of the pie—enough of the dollar that is spent on the records. They've all been unhappy about that, and of course, Mark has had his problems with the artist formerly known as whatever he's known as . . . (audience laughter)

MARK GOLDSTEIN: It's true. Artists are always . . . as Dean put it once, "That's life." I mean, artists are always unhappy, okay. And they will always blame it on somebody else, which is fine. I mean, I've been an artist and, you know, I'll admit that our group sucked hideously (audience laughter), but . . .

JAY COOPER: But you wanted a bigger piece of the action.

MARK GOLDSTEIN: But in fact, I would have preferred to have gotten more for the few singles we sold than what we didn't get.

JAY COOPER: That's right.

DEAN KAY: But I don't think you can underplay the cost of what's going to happen marketing-wise. I think you made a very good point. I think marketing costs are actually going to increase as a result of the Internet because there is so much everybody can get on the Internet now, and somebody pointed out, IUMA and MP3.com . . . the stuff on there, 99.5% of it's garbage. But it's all Internet noise that people have to sift through and there's no filtering that finds anything good on the independent side of it and gets it to the public.

BOB KOHN: That's a great point because, as I said earlier, A&R is going to be more important in the future, not less important. Record labels have a very important role, and a more important role to play in the future than they even have today because they're the ones who are going to be developing the acts, financing the recordings, doing the production of the recordings, matching them up with songwriters and doing that promotion, whether it's the analog promotion or helping with the digital promotion.

MARK GOLDSTEIN: Well, and that raises another issue, which is, you're an artist and you're looking at what you want to do with your career, which is something every artist should do and most don't do in any systemic way, and you shall ask do you need to have a record company finance what it is you want to do with your music? If you want to have big orchestras play behind you and you want to have the biggest producers work with you, probably you're not going to be able to get $500,000 to a million dollars together to do that. On the other hand, if all you want to do is record your Olivia Tremor control-type playing into an ADAT and put that up online, you don't need a record company to do that. You need maybe $1,500 to $2,000 of your own money and some time, and at that point, what does a record company have to offer, whether it's Bob or Warner Brothers? What do we really have to offer?

DEAN KAY: I mean, what do you want to play? Stadiums or toilets? (audience laughter)

MARK GOLDSTEIN: Exactly. No, but the fact is, you know for some people, the only goal is get the music out there. They don't necessarily want to be stars. Some people just want the girls. (audience laughter) Some people start out with the girls and move to a different direction. I've seen it happen. (audience laughter) And I mean that in every possible way. (audience laughter) In looking at where things are going, I think. The competition from a record company point of view, I think is not necessarily selling records. We're looking at making money from the assets we've got and the assets that we believe we can economically develop. And right now, and for the last 50 years, that's been selling some kind of discrete units and paying for making them, and marketing them through ways—which we talked about earlier—they haven't always worked very well. I mean, we got overly reliant on radio. Radio never really, except for maybe the first five or ten years of its existence with recorded music, never really had a shared goal with the music, with the record industry. It happened to work out that way, it was a very nice symbiotic relationship, but there was nothing preordained about it. And we relied on that, probably to an extreme degree. We've had people replacing their record collections with CDs for the last fifteen years, and it's probably allowed us to not to look at how much we've been in denial and how screwed up things were.

What, I think, everybody has to do, and I think they have to do it very honestly, which is hard to do in this business, whether you're an artist, whether you're a publisher, whether you're a new technology guy, whether you're a marketing guy, is how do you add value to the assets you've got, and how do you capture some of the income stream that, we hope, develops. It may very well be that we end up in what's essentially "utility model." You know, right now when you go get water out of the faucet, you don't worry about how much it costs. You pay your bill once a month and the water's there. When you have cable TV, you pay your 40 bucks a month and you watch it and hardly anyone buys into pay-per-view, but as long as you get pretty much what you want, you're happy with that. It may very well be, and I'm not saying it's a good thing, and it's definitely not a good thing for Warner Brothers Records, although it might be for Time-Warner, it may be that basically you've got your little unit there at home which takes up one whole room and you just have it on all the time. If you hear something you like, every once in a while you punch a button, it stores down on your hard drive, somebody captures the fact that the transaction happened, the money gets allocated by some warehouse someplace and that's how it works.

If that's how it plays, that's going to be a different universe. There's still going to be a value from marketing, from development, from publicity, but it may not be that that's a record company function. It may be that there's independent people to do that and independent ways to do it.

JAY COOPER: Let me emphasize that there are five major record companies that probably distribute 95% of all records. The heads of all five companies are not from the music business. They are corporate people. The brand new head of EMI in charge of all the music is from a *biscuit* company. He ran a biscuit company. (audience laughter)

DEAN KAY: Well, they used to call records biscuits. (audience laughter)

JAY COOPER: The biscuits were about the size of a CD so they figured that he qualified. (laughter) The guy for years that ran Warner Brothers and really did a lot of damage to Warner Brothers . . . did a lot of damage to the single best company in this entire business . . . was a fellow who used to settle *prison riots* in New York. I guess that qualified him to handle the musicians, right?

MARK GOLDSTEIN: Yeah, unfortunately, he had left before the Prince problem. That was the real misfortune. (audience laughter)

JAY COOPER: We have a bizarre business in many ways and that's why people are looking for other alternatives. With the possibility of having this great jukebox in the sky, you *may* not need to build a personal record library anymore. I have a library of CDs and books because I like to have the physical thing. That makes me feel good. But maybe the kids today, they don't need to have all of that. By the way, it's very difficult when you're moving to move all this stuff anyway.

MARK GOLDSTEIN: It's interesting you should say that, Jay, because when you look at it. Think what you will about market research, but we've looked at that, and one of the things again that makes the record business kind of weird is . . . well, maybe we're all overly-reflective about things, but people who are in the record business, almost by definition, except for those executives from the biscuit companies, they're into it because they're intense about music. They probably have a collector mentality about music. So they're all used to the idea that if you like something, you buy it.

That is not the way that most people deal with music. For most people, even people our age, when music was more important as a social signifier than it is now, people aren't collectors. If you went to most people's dorm rooms when you're in college, they probably had the few records they had kind of strewn around the room and they didn't necessarily have the jackets together and they were kind of beat up. People don't really care most of the time. If people hear what they want to hear and they can get it on the radio most of the time and it's mostly what they like, they're not going to actually go out and buy it, and to continue assuming that we can get people to do that and continue to do it, it's probably not realistic. The market research we've done seems to indicate that the degree to which people feel the need to buy something has gotten more and more attenuated.

You know, it used to be that record companies figured if we can get two singles off an album, we can leverage that into people buying the whole album and paying for eight tracks they don't want for the two they want. And now you look at it, whether it's because CDs are over-priced or because people don't want to go to record stores because there's maybe too many piercings per person, whatever it is . . . (audience laughter) it now takes somewhere between three and a half to four and a half cuts for people to feel they have to go out and buy an album.

Well, that cuts the leverage down. If we get to a world where with MP3 or with Bob or something where people are buying it track by track, then you lose that leverage. That changes the business model too. All these things are things that you have to factor in, and you have be realistic about it. You have to look it—and I think every company has people at the company who are looking at it that way—and oddly enough, it may very well be that having people who are coming from the biscuit world, and frankly, I did not . . . basically, it's a good thing, but these guys may look at it with a little bit more objective eyes and they may be less sentimental. I'm not saying they will, and I see no sign that any particular company's making any changes, but they may very well be able to say, and be a little realistic and say, "you know what, this may have worked for years, but why the hell is it going to keep working?" And as God knows, that's the kind of analysis that I think has to get made, not just by record companies, but by everybody.

JAY DOUGHERTY: Let me pause for one second because we touched on something here. If people aren't buying records anymore . . . if in fact the celestial jukebox is an adequate substitute for owning the physical record, then the only revenue streams coming in from the records to the record company are going to be performance royalties. What do your contracts say historically? What do they say now about sharing performance royalties with the recording artist, that is, record performance royalties?

MARK GOLDSTEIN: There are a lot of contracts out there . . .

JAY COOPER: I'll tell you what it says . . . (audience laughter)

MARK GOLDSTEIN: . . . that don't require . . . And again, I'm going to add to this question and Jay can going to answer it too, but I can tell you in general, and then I'll tell you about the Warner Brothers world. There are a lot of contracts out there that don't require any portion of that money to go to the artist.

JAY COOPER: That's right.

MARK GOLDSTEIN: There's a whole period of time, where Warner Brothers was just about the only company in the entire business that had a clause in its form that provided that record company performance royalty income of whatever kind, would be split 50% with the artist. And we discovered after having that clause in our contracts for fifteen years or so, and getting the deals we wanted because we were the good guys and often that would help us get the artists we wanted, when the word got out there that because of all the changes that Jay referred to a minute ago, that we weren't necessarily the good guys and we weren't necessarily getting the artist, we decided that it was pointless to have that kind of clause in the form. We were giving something away.

BOB KOHN: You're already the bad guys, you might as well really be that.

MARK GOLDSTEIN: Now here's the scary part. We took that clause out of the contract, and there was a whole group of attorneys out there who were used to seeing that clause (at least if they read the contract and I'm giving them the benefit of the doubt, assuming that they did). They were used to seeing that clause in the contracts. All of a sudden, that clause stopped showing up in the form. You want to know how many attorneys came to us when we started saying that it was out and said, "Wait a minute, man, what happened to clause 2H in Exhibit A?" What percentage of attorneys brought the point up?

JAY DOUGHERTY: I would guess zip.

MARK GOLDSTEIN: You would be almost right.

JAY DOUGHERTY: Did you rule out the foreign? Did you include foreign performance royalties, then, because those were the only performance royalties there were. Or were those specifically carved out of paragraph 2H?

MARK GOLDSTEIN: No, no, the contracts have . . .

JAY COOPER: It was a clause in their contract that said that they would pay a portion of the performance royalties, and a number of us have asked for that clause on a continuing basis from all of the companies, and it's a *fight* to get it. It's now becoming even more important.

MARK GOLDSTEIN: But that number, which does include Jay, by the way, is not that big. I mean, there are some attorneys that have some pretty big clients who, not only do they not ask for it when it's not there, but even when they had seen it before and now it was gone, they still didn't ask where it had gone, which, frankly, just scares the hell out of me, as someone who used to be an artist. I have kids who want to go into that business. I hope they get represented by people like Jay.

JAY COOPER: I also have to tell you, which is fascinating, this whole discussion and the discussion before, it was all about marketing. Don't you find that fascinating, it's all about marketing. All of these companies, these big corporations, are all about marketing. What happened to the music? What happened to the thought about music and finding music and developing new artists and all that? You don't hear that conversation *at all* anymore with these companies. You hear marketing.

DEAN KAY: Well, that's because there's "corporate radio" telling the record companies what it is they want to hear so that their audiences won't turn the radio off between commercials. I mean, music is secondary to getting from commercial to commercial.

MARK GOLDSTEIN: And you know, it always has been. It's just that there are now it's more intense. One, there are a lot more alternatives for radio, and two, there's a lot more money at stake. You know, all these consolidations and all these prices that these people are paying for radio stations—if you're a PD and you're not delivering better numbers every week, you know, you're in tough shape, and therefore, it is really hard. Even if you go to Jeff McCluskey, who's got whatever exclusive deal he's got with whatever hot stations he's got that control, God knows, what part of the market, you still don't know that you're going to get it.

JAY COOPER: It's not payola, it's not payola, it's not payola.

MARK GOLDSTEIN: No, I know, not at all.

JAY COOPER: Jeff told me so. (audience laughter)

MARK GOLDSTEIN: And the *L.A. Times* gave it its approval, too. No, but the fact is, it is tougher and it is much less about music because you still have to get people to buy. Yet most people will not buy something just because the cover looks interesting. They gotta hear something, and getting them to hear it is tough, and even if you use the Net to get them to hear it, they still have to find it there.

DEAN KAY: Tougher thing. My other hat is being on the Board of Directors of ASCAP, and I've said for some time that probably if a majority of the income for songwriters and publishers in the future is going to be the performance side of things, as opposed to the mechanical side of things. However, I also believe that there's going to be a vertical integration, and then eventually what's going to happen is people are going to be able to create the music and sell it *through* right from creation to sell-through, and I think that the people that are best placed to do that are the major record companies who have a tremendous catalog—a back catalog—where they can actually start their own radio stations, they can actually create the music and get it out on the Internet and finally, as we're seeing happening with what BMG and . . .

MARK GOLDSTEIN: And Seagram and (inaudible)

DEAN KAY: . . . and MCA, starting their own website, which is going to have a tremendous catalog, and I think catalog is going . . .

MARK GOLDSTEIN: I agree with that.

DEAN KAY: Also, supplant some of the losses in pirated income.

JAY DOUGHERTY: Bob, could you address the performance royalty share? Does a digital record company like Goodnoise share performance royalties with its artists?

BOB KOHN: We don't have any performance royalties, we don't have a radio station, we just simply do digital downloads. We're focusing on that, so we're paying mechanicals. Or, let's say with the recording company or the label or the recording artist, we're paying them a share of all the income from a downloadable file.

MARK GOLDSTEIN: What about the performances—don't you use performances of your recordings to sell your records, to sell your downloads?

BOB KOHN: Yeah, but that's all clearly provided.

JAY DOUGHERTY: Just through you. No third parties?

STEVE MARKS (*Audience Member*): If somebody on a webcasting station wanted to make an interaction use or something and came to you for a license, I think that's the kind of thing they're asking.

BOB KOHN: We would pay 50% just like we do after our costs right to the artist, to the record label. That's just pretty standard. But we really don't plan on going into that business. There are other people who are much better at doing it. This is all the problems that are . . . have arisen being in that business.

JAY DOUGHERTY: So radios don't play your artists' records?

BOB KOHN: Well . . .

JAY DOUGHERTY: Not that radios pay performance royalties, either, but I'm trying to build up to what we. . . where do your records get played?

BOB KOHN: Terrestrial broadcast stations? Sure.

JAY DOUGHERTY: Any radio or radio equivalent? In other words, Internet stations.

BOB KOHN: I don't know. Don't assume that . . . I'm not a record label. I'm not developing acts, okay. I'm not signing new artists. If they're an artist with a brand name, I'll sign them. I'm signing independent record labels, catalogs and new music.

JAY DOUGHERTY: But you own sound recordings.

BOB KOHN: I don't own sound recordings. I do not own sound recordings.

JAY DOUGHERTY: Your artists license you the sound recordings?

BOB KOHN: No, they're licensing me the right to do digital downloads.

JAY DOUGHERTY: Who owns the sound recordings?

BOB KOHN: Somebody else.

JAY DOUGHERTY: Who?

BOB KOHN: Either artists or primarily independent record labels.

JAY DOUGHERTY: Okay, so I guess my question should have been aimed at them. What do they pay their recording artists?

BOB KOHN: I have no idea. I have no idea. I assume it's . . .

JAY COOPER: Well, it's back to the contracts.

MARK GOLDSTEIN: You're back to what the contracts don't provide.

BOB KOHN: But they're independent . . . Well, they're independent record labels for the most part, so most of them have been a little bit more forthcoming in terms of giving better rates to the artists and also having that provision that provides them 50% of the performance.

MARK GOLDSTEIN: Well, some of those deals are just 50% deals. You know, a lot of the deals don't have royalty rates, it's just basically 50%. It covers publishing and everything else, too, but they get 50% of all the income that comes in.

AUDIENCE MEMBER: Just to clarify this, anything that comes under the statutory rights . . .

MARK GOLDSTEIN: Right, there is a statutory right.

AUDIENCE MEMBER: 50% goes to the artist.

BOB KOHN: Right.

JAY DOUGHERTY: But very little comes under the statutory license now.

JAY COOPER: Very little comes under that.

MARK GOLDSTEIN: Right.

JAY DOUGHERTY: Assuming that webcasting is used eventually to promote records, then they'll be performance royalties from that, right?

AUDIENCE MEMBER: Right.

JAY COOPER: Right now I'm working on a couple major multi-artists concerts that are going to take place this year, and they're going to be webcast. We're preparing for that. Now, of course, can they duplicate it? We could have our problems, but they're going to be webcast, and we're going to see what's going to happen. Fortunately, the sound is still okay. It's still not great in most instances, but it's going to be an interesting experiment because it's going to be done from multi venues and throughout the world, obviously. So it'll be interesting to see what happens and what kind of protection we have, it's going to be a big experiment that everybody wants to do.

JAY DOUGHERTY: Can those type of performances be encrypted or watermarked? Allen, do you know? Is it possible to technologically secure those kinds of performances?

ALLEN EASTY (*Audience Member*): Most of the webcast technology are going to be used like the real networks, broadcast network, which I think is the most common infrastructure environment, does not actually support inline encryption, so. . . that's generally not going to be the case.

JAY DOUGHERTY: So that's as bad as the CD, it's clear.

ALLEN EASTY: But the point is . . . here's an interesting analogy. Stealing that quality of audio is a little like kidnapping the homeless. (laughter)

BOB KOHN: Wait, wait, wait. There's something . . . well, Real Audio, or Real Networks, just bought Xing technology, and they got some really nice streaming MP3, and our Free Amp product will also have that kind of technology, and that's using M-bone and all that, all right. But let's go . . . just before . . .

DEAN KAY: I'm sorry.

BOB KOHN: Go ahead. No, no, no.

DEAN KAY: No, no . . .

BOB KOHN: No, no, you're the Board of ASCAP. Go, go. (audience laughter)

DEAN KAY: No, this is something unrelated.

BOB KOHN: Okay, all right. This is something that's somewhat related. I don't think it's going to be performances and streaming on the Internet. That's not what's going to happen. As bandwidth increases, as I said before, there's no relationship between the time it takes you to consume the music and the time it takes it to get downloaded to you. When you have increasing bandwidth, and it takes like eight seconds for the whole song to get to you, it will send the song to you, it will cache it on your local computer, and you've got to decide whether to delete it or not, so it's always going to be a digital phonorecord delivery, and the music . . . Well, it's an open issue as to whether that's also a performance . . .

SEVERAL: Yeah. (laughter)

BOB KOHN: But I won't start up with that, but it will be a digital phonorecord delivery. For the music publishing companies that means it will always be a mechanical unless they agree it won't be or some lower rate like an incidental mechanical, and for the record companies, it will always mean that somebody will have a copy at home. So, that's one thing. So the question as to whether streaming has any protection in it, I don't think it's terribly that important. The question is whether copies are going to be made, and that's an interesting issue, but I want to go back on the encryption because some words were said about encryption earlier that I wouldn't want the audience to be entirely misled because at first, our company is agnostic. We're software company people, and the first decision that a software company makes is what platform do I support? I mean, I'm going to write a spreadsheet program. Do I write it for Windows, for DOS, for CPM, for Macintosh? What do I support? I support the platform that's most installed, and today that's Windows, right? Well, in this area, what platform do I support? What's most installed? Well, Liquid Audio's telling me they got 200,000 people with clients downloaded after three years of work. A2B's telling us 200,000 downloads. Win Amp is 15 million. Every copy of Windows 98 supports MP3. Every copy of Netshow supports MP3. MS Audio has zero installed base. The Justice Department is . . . well, I'm not saying MP3 is the end-all in quality for codec because E-pack by Lucent is clearly better, and I'm not sure whether the Microsoft demonstrations were honest to begin with, but perhaps it is better. And there could be better codecs. The question is not whether what codec is chosen—the compression technique—the question is, is whether there's going to be some form of protection in it and or not, all right. Now, so, there are three forms that are being bantered about. One is called digital signatures which hasn't been mentioned. The other's called watermarking, and the other is called encryption. Encryption will not work to protect music on the Internet period. It just won't. I was VP of Business Development for PGP, the largest deployed encryption product in the world. Our VP of technology wrote half of PGP. It won't work for very good reasons. It's the wrong technology for the application.

Encryption is good at keeping a third party out of a conversation between two people, but with encryption, you gotta trust the recipient.

If I send an encrypted message to Jay. . . What encryption is really good at, like PGP, I scramble the message, send it to Jay, and it keeps this Jay . . . keeps Mark out of that message. As a matter of fact, the National Security Agency said to Congress that if you . . . it would take 12 trillion times of the age of universe using every computer on this planet to break a PGP encrypted message, or a well-encrypted message. Mark is not going to get into that message that I sent to Jay Cooper, but Jay has to decrypt the message in order to listen to it, all right. So, I have to trust Jay. He can take my attorney-client privilege message and just post it to the *New York Times* or post it on the Internet. But what's happening here is that the music industry is trying to apply a technology that depends upon trusting the recipient where the recipient is the consumer, the very person you don't trust. So it's very easy for a consumer, when he decrypts the file, plays it, you can put a piece of software right before the sound card, grab every 0 and 1 and lay it onto your hard disk unencrypted, and that's what . . . there's something on the Internet called A2B to wav. Double-click on an A2B or Liquid Audio file, and it completely un-protects the music.

Now, wait, I'll go to watermarking, okay. Watermarking is next. That's a useful technology—like encryption is like having a secure channel to Linda Tripp, all right. There's nothing you can do to protect the other end. (audience laughter) Okay, so, watermarking is a little more interesting because it doesn't prevent you from copying anything, but it will mark the files so that you can sort of deter piracy. The problem with watermarking is, at least as of today, I don't know of any watermarking technology that does the session watermarking. There's a patent out there, but there's nothing working. In other words, when someone comes to our website, they type in their credit . . . they click the songs that they want, a couple of tracks, they click on.. . . or add it to their shopping cart. Yes, I want to buy. If they don't have their credit card and you type the credit card number. You type your name, your address, your country. Click "buy," we immediately, right now, clear the credit card transaction, send you an invoice by e-mail and present you with a page where you can download the songs. If you've got a T1 line, it's eight or nine seconds to download each track. If you're on a 28,000 bit modem, it's about 15 minutes to download a track. 50% of college students have T1 access in their dorm rooms, okay. Now, the next thing we're going to be doing is, we're going to take PGP technology or any DSS digital signature, sign the file with the customer's order number. We're not going to sign it with their name or their credit card, cause that might be a privacy problem, all right.

We sign it with their customer order number, we can then, if they post it on the Internet, we can trace that it's them. But you can get around that. They steal a credit card, use a false name . . . that's not necessarily going to work. Watermarking currently doesn't let you sign the file with the person's name in it in a short amount of time. In other words, it takes the whole three-and-a-half minute length of the song to watermark the song. No one's going to wait three and a half minutes to do that download before it starts. So watermarking is not going to work for the purpose that everyone says it is. It's a total sham, right now. Hopefully, someone will have some good technology and we're very open to using it. We're going to use digital signatures first, but let me just say, encryption will not work to protect music.

Now, people might feel real comforted that Microsoft and Real Audio and all these guys and SDMI and Audio Explosion, A2B, but you said earlier, you know, A2B and Liquid Audio failed. You can't give away a Liquid Audio file. You can't. There's no consumer demand for it. Now, if someone demands one of these things, fine, we'll use it. But what happens when your mom loses her private key? You lose your private key on your hard disc, you've lost your entire music collection, okay? And no one, Harry Fox is not going to let you download all those songs again for nothing, all right. So, it's a huge customer service issue with public key cryptography. I know, that's why we had to sell PGP to Network Associates because we couldn't make it yet. It's much too complex for the public to really understand in 1999. I've had my say.

AUDIENCE MEMBER: You're predicating your entire argument on the prevailing PC architecture, and what we're doing in SDMI is not predicated upon this.

BOB KOHN: So, Microsoft's going to remove the copy command, right? They're going to remove the copy command from the operating system? Then you're going to have Linux?

AUDIENCE MEMBER: There are over a hundred multi-billion dollar companies participating in SDMI that think you're wrong.

BOB KOHN: Well, I wouldn't . . . and Sony did a really good job with Betamax, right? (audience laughter)

MARK GOLDSTEIN: I wouldn't say that they think they were wrong. You know what? Honestly, I mean, I wouldn't say that all those SDMI companies think that Bob is wrong. I think that the theory that we all have going into SDMI is rather that, look, we're talking about 10% of the population. There's 80% of the population that, whether because their mom and dad raised them right or they went to church or they believe in powers above, they're not going to steal stuff if you tell them it's wrong to do it. Then there's 10% of the people who are going to, no matter what you do, find a way to break any kind of encryption, watermark . . . they're going to screw with it and they're going to take it as a challenge and the harder you make it, the more they're going to screw around. You can't do anything about those people. You write them off. Then there's 10% of the people that, if you have something where they can get what they want if they play by the rules, they'll do it. And like I said, we've got all this clean stuff out there already, and every record company knows that, and then stuff can be uploaded and no matter technology we develop now, there's nothing we can do about that.

BOB KOHN: That's fair enough. There are enough people who will pay for the music.

MARK GOLDSTEIN: So it's that 10% you want to deal with—the ones that you can actually affect in some way, and if SDMI, after we push this thing through on this accelerated process and we get something that works, and I think probably there will be something that comes out of it that is good enough for that 10%. But you're never going to deal with the other 10%, and the other 80%, I don't think, you know . . . there's some slippage there, but that's not the issue.

JAY DOUGHERTY: I think we're going to need to wrap it up, basically, but we should take maybe five more minutes of questions from the audience.

AUDIENCE MEMBER: A question for Jay and for Mark. In terms of negotiations, Jay, if you're representing the artist and, Mark, if you're representing the company who's doing the license for a master, are you trying to exclude at all or, and successful at all in excluding the digital rights, download rights, from the artist contracts, and Mark, when you're writing a license for, let's say, use of a master, to a company that, let's say, wants to do a compilation record? Are you excluding his download rights?

JAY COOPER: Okay. That's a very good question, and the answer is, I'm trying to exclude it, and the reason I'm trying to exclude the digital, the downloading rights, etc., is because I don't know the value of the market right now.

BOB KOHN: Oh, I'll tell you.

JAY COOPER: I don't know what it's worth. All guesses asides, I really don't know what it's worth, I don't know what it'll be in the future, I don't know which way it'll be sold in the future, and so I want to preserve those rights.

BOB KOHN: Have you been successful?

JAY COOPER: I'd like to leave it to future negotiations.

BOB KOHN: Have you been successful in preserving rights?

JAY COOPER: I've been limitedly successful, yes.

BOB KOHN: Great.

MARK GOLDSTEIN: Yeah, I think there are many people who ask for that kind of clause. We have been quite successful in not granting it. (audience laughter) As far as the licenses that we grant, when we license stuff to third parties, it generally goes to our agent, Warner Special Products, and as anyone out there who's dealt with anyone at Warner Special Products can tell you, they can be highly difficult.

JAY COOPER: Yes. Absolutely.

MARK GOLDSTEIN: And they can be obstreperous and being difficult . . .

JAY COOPER: Yes.

MARK GOLDSTEIN: . . . and one of the points about which they're difficult is, you know, their form license does not include distribution in this kind, and digital transmissions. It's causing us some problems because when we want to do soundtrack deals the other way, other companies are saying, "Wait, why do you want those rights when Warner Special Products won't give them to us when it's the other way around?" Those things are getting worked out, but when we grant those rights, and there's a document in here that kind of shows you all the kind of limitations we put on it, it's pretty limited rights.

JAY DOUGHERTY: Warner Special Products doesn't even grant home video rights in master use licenses. They limit it to video cassettes and video disks. It'll be interesting to see their use of videos online under those licenses. Way in the back in the green shirt. You had your hand up?

AUDIENCE MEMBER: Yes, you were talking about 10% of the people who can do this, and 80% that can't and the 10% will be honest anyhow. But you don't seem to address the fact that the other 10% who can do it and take that file and, say, once they've done it, and go ahead and e-mail it to a fair portion, of if not nearly 50% of the 80% . . .

MARK GOLDSTEIN: No, I'm saying I understand, but that's what I'm saying. The fact is, you know, all it takes in this world is one breach of the wall, and it goes up someplace and then the game is over with respect to the people that want to mess with that. Now the fact is, there are still the 80% of those people who aren't inclined to "steal stuff.". If they're inundated with free stuff and the word gets out , even if it may not be okay to be there, we're not really going to mess with it. It's like going 70 in a 65 zone and nobody really cares, you're right. And what record companies would like to do is get in early enough in the game so that we can get the mindset for those 80% of the people that want to do the right thing. Even though the stuff may be there, it's not cool to take it, and we've provided you an alternative that is not obtrusive, that allows people to make money from it, and if you play by the rules, it'll be better for everybody. Now, that's a message that is not an easy sell, but if you get started early enough on it, and the alternative for that 80% is such that they don't feel that their access is restricted and they feel they don't have to jump through hoops to get what they want, you gotta hope that you can deal with that 80%. I agree with what you're saying.

JAY COOPER: I have two answers to that. One is, if a helicopter flies up above and drops a whole bunch of hundred dollar bills, every honest person who's sitting down below is going to grab for those $100 bills. If it's out there, they're just going to go for it. They're not going to pay attention to it, and another thing is, there's a large segment of the population out there that believes that music is free. That music on the Internet *is* free, and they don't understand the concept of paying for it. They really don't because they're not getting a physical . . . they're not buying a physical disc with a cover and package and all that. *They think it's free.*

MARK GOLDSTEIN: I don't think we disagree. I think I'm saying you gotta get in early with an alternative so they don't have that attitude. Absolutely right. I think we agree.

JAY COOPER: It's not too late.

BOB KOHN: That's right.

JAY DOUGHERTY: Did you have a question?

AUDIENCE MEMBER: I've heard you talk about the encryption technology. I've heard you talk about watermarking technology and this Digital Signature technology. I haven't heard you mention anything about serial copyright management, where you can basically reduce a digital copy into something that can't be copied multiple times.

BOB KOHN: That's . . . serial copy management was something in the audio home recording. That's about seven-year-old technology. That's not working.

JAY COOPER: Does it require it being embedded in the hardware?

BOB KOHN: But you can always change the 0 back to a 1. A user can do it very easily.

JAY COOPER: Does it require being embedded in the hardware?

BOB KOHN: It has to be a hardware base, and you can't control every computer on the planet. You can try to control the peripheral devices.

AUDIENCE MEMBER: . . . that's another 10% (inaudible). If he hasn't changed the hardware, and to change it, you're going to have to change everybody's hardware.

BOB KOHN: That's right. That's what they're trying to do with the Diamond case.

AUDIENCE MEMBER: So I mean, but if you have the hardware. . .

BOB KOHN: 85% of the sound cards of the world are

JAY DOUGHERTY: So it can be serial-copy managed or not?

STEVE MARKS (*Audience Member*): No, no, no. . . serial copyright management is something totally different.

BOB KOHN: So you're going to develop an SDMI that doesn't work on 85% of the world's sound cards. That's pretty smart. That's well-adapted technology, I'm sure.

JAY DOUGHERTY: Well, let's do one last question in the back there.

AUDIENCE MEMBER: Creative Labs is a member of SMDI.

BOB KOHN: Sure, and I'm a member of SDMI. We're a member of SDMI. You got 10,000 bucks, you can do it, all right. Not too many independent record companies are members of SDMI. I don't think there are any.

STEVEN MARKS (*Audience Member*): That's not true.

MARK GOLDSTEIN: Yeah, that's not true.

BOB KOHN: How many?

JAY DOUGHERTY: One last question in the back there?

AUDIENCE MEMBER: I really want to add something to what Jay said, it's apropos. The encryption situation, because this is so much different of a business than any business that has come before, because what's being vended here or what is about to be vended are electrons, it is not a physical thing. And just the same way that the television business was right after radically different from the movie business, even though there were stories and there were celluloid depictions. Nevertheless, it required a completely different mindset. And what's happening here is, and it's apropos to what Jay said about the biscuit executives, is that just like television people understood that medium, and they prevailed in a medium over those people who only understood theatrical releases. Similarly, these Congress people who understand how to use this medium are the ones that will prevail. And it's something to look at. Those people are the people we want to go to, particularly because there's been a change in the patent laws that allow for the patenting of processes that are so-called business methods when they're associated with the Internet. That's why things like encryption, or digital watermarking, or any kind of security device actually goes hand-in-hand *with* the market. That all of these things are going to generate brand new methods of doing business on the Internet that are . . . then, people that will prevail are the people that understand this E-commerce, and *they're* going to get the patents. They are the ones that I would suggest you all look at. The people that are the E-commerce entrepreneurs of right now. Prior to the patents and putting these things together, they're going to know how to get the material, get it to the consumers, and in some cases, it's going to be free and it's going to be attached to something else that doesn't have security and a copyright problem and there will be an appropriate offset economically. But I think it requires a completely different way of looking at this.

JAY DOUGHERTY: I didn't hear the question.

AUDIENCE MEMBER: There is no question. (audience laughter)

JAY DOUGHERTY: I guess we'll conclude on that note. I think we should pick up with that issue at next year's symposium. I want to thank you all again for spending your Saturday with us.

Thank you.