

REMARKS OF EDGAR BRONFMAN, JR.
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TO THE PROGRESS & FREEDOM FOUNDATION
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Thank you and Good morning.

It's a great honor for me to have been invited to a real-life think tank. It's not very often a music guy gets the chance to be associated, in any way, with actual thinking. So it's truly a privilege to be able to address such a distinguished group. I want to thank George Keyworth and Ray Gifford of the Progress and Freedom Foundation and especially Jim Delong and his colleagues at the Center for the Study of Digital Property for making today happen.

I think it's fair to say that when it comes to content or information we now know as merely sequences of zeroes and ones it's been the music industry that has been the most profoundly affected: both positively—starting more than two decades ago with the revolutionary introduction of the compact disc—and more negatively over the last half decade or so with the advent of P2P file sharing.

As the industry whose content has been the most profoundly affected, we are keenly aware that the eyes of not only other content businesses are upon us, but the technology community and policy makers around the globe are watching us as well. We are being closely observed to see if the music business can adapt and thrive in this ever-evolving digital labyrinth or if we wind up succumbing to what has often seemed to be a life-threatening set of circumstances.

Earlier this year, I said that those people who were positioning the Grokster case as a battle between technology and content were either disingenuous or completely missing the point. I said that the law is not such a blunt instrument that it cannot distinguish between commerce and theft. However, it is important to understand that the content industries were not advocating a ruling that would inhibit the development of new technologies. As I'll expand upon shortly, new technologies invariably promote the growth of content businesses.

And the rights that are at stake here are not exactly small potatoes. Intellectual property in all its many forms and permutations is the present and future backbone of the U.S. economy. In 2002, the copyright industries accounted for 6% of our country's Gross Domestic Product, 12% if you include related and supporting industries. That's well over a trillion dollars and there's no question that number will increase over time.

Happily, on June 27th, to the relief of artists and copyright holders everywhere, the Supreme Court rendered a unanimous decision that does not inhibit technology, yet does, critically and importantly, give recourse against those who try to build their businesses on

copyright infringement. Sensibly, the Court's opinion turned not on Grokster's technology, but on its business practices.

So, now what?

That's what I'd like to talk to you about today to get the ball rolling for the panel that follows. A few prognostications from a music guy about what he thinks the post-Grokster world might look like.

First, the Court's decision will not eradicate online piracy. But the industry was never so naïve to think that it would. Let me read something to you: "Pirates in this business not only steal ideas, they steal entire records also. In no other business is it so difficult to reap the reward received." Sounds like a recent RIAA press release, right? But it's not, it's from an article published in an 1898 trade journal *Phonoscope*, referring in part to the increasing prevalence of "pantagraphic" machines which made illegal duplicates of cylinder recordings.

And of course today, physical piracy—while not the focus of today's discussion—continues to be a massive plague on the music industry. Each year we lose close to \$5 billion dollars to physical piracy worldwide as giant duplicating plants churn out massive amounts of illegal product in markets as diverse as China, India, Africa, the Middle East and Eastern Europe.

So, while we'll still have to live with piracy, the Grokster decision affirmed certain important principles: that the Internet does not exist outside the law, that "cyberspace" is not synonymous with "anarchy" and that protection of copyright retains both its legal and moral underpinnings.

There are many new participants in today's music industry: ISPs, DSPs, wireless carriers and universities are just a few. And, after Grokster, each one bears a heightened responsibility in working with music companies to protect the content that flows through their systems and in educating consumers about what's right and what's wrong. Remember: many of these consumers have come of age accustomed to accessing free music online; they have little understanding of the world before P2P.

Secondly, I believe the Grokster decision will positively affect the development of new technology. The future of the music and other content industries will be, as they always have been, dependent upon the opportunities that accompany technological innovation. And that is why it is vital that those technologies are designed and promoted in a way that respects and supports copyright.

While the Grokster litigation has thrown a spotlight on the Internet, the intertwined destiny of music and technology is hardly anything new.

For example, in 1925, when Igor Stravinsky composed his "Serenade for Piano," he wrote each of its four movements specifically to last under three minutes, not for

aesthetic reasons, but because he wanted to compose something to fit the time constraints of a 10-inch 78-rpm record. Stravinsky was not an isolated case: the art of songwriting, too, adapted to the technology of the day; it's no accident that, for years, the length of a pop song was three minutes or less: designed to conform to the amount of information that could fit on a 45-rpm record.

As kids today take the Internet for granted, as if it always existed, we too tend to do the same with the technology of our own generation. So we may not have realized that it wasn't until the birth of the 33-rpm LP that songs regularly became bundled into a 40 to 50 minute collection we came to know as the album or that popular songs could be longer than three minutes.

The history of singles and albums—whether on vinyl, 8-track, cassettes or CDs—reflects the fact that artists compose songs with an innate understanding of technological parameters, and music companies develop different economic models based on those parameters.

The point, I think, is clear. Technology shapes music. Music drives technology adoption. If you need any further proof, just look at the iPod.

But the tumultuous advent, a few years ago, of peer-to-peer technology upset this symbiotic relationship. In the blink of an eye, business models and platforms were turned upside down, creating an atmosphere of fear and mistrust between content and technology.

Suddenly, everything was available instantly and in every combination. Music companies and copyright holders were terrified. And both the content companies and the technology community failed to adapt to the new world as quickly as we should have.

The music industry, like almost every industry faced with massive and rapid transformation, first responded too slowly and too moderately, inhibited by an instinctive and reflexive reaction to protect our current business and business model.

At the same time, many in the technology community, chip makers, software and hardware producers happily watched the sales of PCs soared as people were able to access music for free on their newly purchased computers.

To the technology community, content owners became Neanderthals who were too scared or too stubborn to understand the new world being ushered in by revolutionary technologies. To the content owners, the technology community was too arrogant or too self-interested to accept that no matter how revolutionary their innovations, the fundamental fact of property ownership would not be undone.

To be fair, it wasn't as if either of us could simply flip a switch and make all music content available legitimately on the Internet. Not only involved was the content community's fear of the new and our reluctance to change, but technology companies

had to develop the software that could translate this powerful distribution platform into a legitimate commercial endeavor. That is no small task when one considers the need to support potentially tens or hundreds of millions of tiny transactions per day, with each transaction containing different and multiple ownership and royalty streams.

So, as the music community clung to the past and as the technology community was divided as to whether or how to become involved, a vacuum was created which illicit services like the original Napster and later Grokster (and many others) were more than happy to fill.

Then, out of this logjam, came the cries for compulsory licensing: Some said, "...force the music companies to make everything available." And, even more extreme were those who asserted that copyrights don't... and can't... and shouldn't work in the digital world. And adding to the suspicion and mistrust between content and technology, it was often those who held that patents can and should be protected in a digital world who were the most vocal in saying that in that same world, copyright protection was a thing of the past.

But compulsory licensing, which is a solution to a problem that didn't and doesn't exist, is absolutely the wrong approach to resolve an admittedly difficult but not insurmountable challenge.

The central tenet of copyright is that the owner of a copyrighted work has the right to determine how that work is exploited. A compulsory license, which takes away this right, is appropriate only when there is some reason why ordinary market mechanisms cannot work. I do not hew to the view that businesses which exist by violating copyright should be regarded as ordinary market mechanisms.

Compulsory licensing substitutes the free and open marketplace with government regulation—never a good thing—and to my earlier point, it's a solution to a problem that doesn't exist. Compulsory licensing is particularly inappropriate since we and other content owners are already licensing broadly and we are continuing to grant more licenses for our content to a wide variety of Internet and wireless services and distributors throughout the world.

In fact calling for government regulation is incredibly short sighted. For example, we don't believe the government should step in to solve many of the issues that currently beset technology, for instance: interoperability and standards.

As a content company, we, quite naturally, want devices out there that permit consumers to seamlessly access our music, without their having to worry about compatibility of operating systems or DRMs—whether on the cell phone, computer, portable device—you name it. The consumer's digital music experience should be as seamless and rewarding as possible. So we would be hypocrites to suggest that the government should force interoperability or standards on device makers, while, in the same breath insisting that there is no need for compulsory licensing.

Simply put: We don't believe in government-enforced standards. They fly in the face of what history has shown us over and over again: That the economic incentives of proprietary technology inspire innovation just as economic incentives promote creativity in content.

A further word about innovation before I move on to my final point about the effect of the Grokster case. We usually associate innovation with technology companies, but they aren't the only ones who must innovate. To survive and prosper, content companies must do so, as well. And even our very concept of copyright must innovate.

In that regard, let me perhaps surprise some of you by saying that I'd like to salute Stanford Law professor Lawrence Lessig, and here's why: While Professor Lessig and I disagree on a host of issues—copyright term length and compulsory licensing to name just two—we do agree on a critical—maybe the most critical—point: That artists and copyright holders must have the right to determine how their works are exploited. And as Professor Lessig has written: “authors and creators deserve to receive the benefits of their creation.” With the formation of Creative Commons, Professor Lessig has opened up the copyright dialogue to in-depth examinations of how flexibility and innovation in this crucial area might benefit us all.

Innovation leads me to my third and final prediction. The decision in the Grokster case creates an economic incentive to invest in the digital music space and will further encourage not only the growth of a vibrant creative community, but will inspire further technological innovation that will accelerate the growth of legitimate digital music services.

I've always been a great long-term believer in the value of music and the critical role it plays in our everyday lives. Even before the Grokster decision, I was confident that the Courts and lawmakers would ultimately recognize the importance of protecting intellectual property. It was precisely these motivations that were behind our acquisition of Warner Music Group from Time Warner last year.

We believe even more today that new economic models which can take advantage of the distribution power of the Internet and wireless platforms will lead to a true renaissance of the music business. At the time our acquisition closed, digital revenues accounted for essentially none of WMG's revenues. Today, as of our last quarter that number is 6%, a phenomenal change in just five quarters.

And already WMG has led the industry with a series of firsts: the first music company to offer music videos for digital download through a wireless carrier, the first music company to reach an agreement between its recorded music and music publishing divisions for use of songs on mastertones, ringback tones, DualDiscs and other new digital formats, one of the first to make ringback tones available in the U.S., and the first to provide consumers access to shop, preview, purchase, play and store full-track downloads globally on the cell phone.

While the music industry is now adapting to change, I'd like to mention just one of many initiatives WMG has started that illustrates some of the ways we are adjusting our business model to today and tomorrow's reality:

A sad story, one too often repeated in the music business these days, is that of a young artist who is dropped when his major label album debut doesn't sell. While the old system allowed an artist time to develop and grow, today's business is such that an initial commercial failure for most artists means they no longer get a second chance.

At Warner, we believe that we can create a digital-only label, what we're calling our "e-label" that will transform the process for artists young and old and possibly give the stories of artists struggling to be heard, a new and happier ending.

At this new label, an artist can develop in a supportive, lower-risk environment. And what's revolutionary about it? An artist is not required to have enough material for an album, only just enough to excite our ears. Rather than releasing an album every couple of years, every few months the label will release "clusters"—three or more songs—by an artist. And, finally, and perhaps most revolutionary, artists retain ownership of their masters and copyrights while signed to this label.

At Warner Music Group, we don't view ourselves as simply a financing, marketing and distribution company. Our most important job is to work with artists and help them hone their craft and then to help them expose their work to the consuming public.

We are excited by the power of digital distribution now available to every potential artist. We see our mission as not to control the means by which artists' voices are heard, but to amplify those voices. And the more those voices are amplified and distributed through more and more channels, the more we empower consumers to make emotional connections to the artists and music they most want to hear. We believe the e-label will be one of many steps we will be taking to fulfill that mission.

Over time, our success will be measured by our ability to identify and develop powerful creative voices and share them with the world. And those voices deserve to be rewarded and compensated for their work. A strong and respected copyright regime will help them achieve just that.

As a music company, we also understand that our ultimate success lies not in preventing people from getting what they want but in providing it to them in new and exciting ways. The music and technology industries are facing the greatest opportunities we have ever faced. Let's not diminish those opportunities by fighting internally or amongst ourselves. Let's not limit our own credibility by blindly toeing party lines. By continuing to strike a balance, we can nurture technological innovation while at the same time protecting the very content that inspires innovation and technology adoption in the first place.

Clearly, content and technology both need each other and benefit from each other. Now that the Grokster decision has established and affirmed a framework that outlines the

ways in which we can work together, let us focus on the opportunities to prosper through collaboration. If we do so, not only will we both grow more profitable, but we will enhance the experience of people everywhere, whose lives are made richer by an ever increasing opportunity to access the content, in this case, the music they love.

Thank you.