

>>FEMALE SPEAKER

Good morning everybody. I am Julie Meyer an attorney with the Northwest region of the Federal Trade Commission. Welcome to Seattle and our lovely weather. We have to have a weather reference. In a minute we will be hearing from Professor Bill Covington who runs the Technology, Law and Public Policy Clinic here at the University of Washington School of Law and who is responsible for allowing us to use this impressive facility for today's town hall. I will let him welcome you to the law school and tell you more about his program, but I want to make sure that everybody knows, as you can see, from the agenda, we have a full day ahead of us. We plan to stick to the time allotted for each panel. We will do our best to make sure that audience members get the opportunity to ask questions during most of the panels but please note that we have set aside a full session at the end of the day to hear from you and provide what responses we can to your questions and comments. Finally, the audience today is not just everyone in this room and possibly next-door but also the virtual audience who will be watching this from our live webcast and who will also be able to ask questions by e-mailing them to [DRM town hall@ FTC.gov](mailto:DRM_town_hall@FTC.gov). Those questions will be passed along to moderators to ask panelists and we will try to remind everyone of that e-mail address throughout the day. Finally, please turn off all mobile devices that may beep, buzz or otherwise disturb others. Thank you again and please welcome Professor Bill Covington. [applause]

>>MALE SPEAKER

Thank you Julie. Let me extend a welcome to you from the University of Washington School of Law. We are pleased to host the session on digital rights management. We hope our environment can be conducive to an exchange of ideas and maybe getting us closer to identifying some solutions. A quick word about the Technology, Law, and Public Policy Clinic. It is aimed at students who are interested in studying the intersection of high technology and public policy. Students in that clinic spend a year looking at the business aspects, the public concerns, and the current state of the law in areas such as DRM, RFID, biotech and telecommunications. We are hoping to create a generation of lawyer technologists who can get us closer to the best possible public policy. Some housekeeping matters. The restrooms are located, you will turn to the left, go to the end of the corridor and jog to the left. They are across the hallway from the elevator bank. In the spirit of the current economic times, we will not be serving refreshments. We will turn you over to the private sector. The Burke Museum has a fine coffee shop, which is located directly across the parking lot behind the building. Most important issue, Wi-Fi access. For those of you want to get online your username would be UW law 0100. UW law 0100 and the password FTC town hall. Again that is FTC town hall. These proceedings will be webcast live. And archived for later viewing on the FTC's website, which is www.FTC.gov. A written transcription of today's proceedings will be available on that same website. That concludes the housekeeping measures. If there are questions of any kind, please feel free to ask me or any of the other UW staff

that you see in the area. I would like to start today's proceedings by introducing Ms. Mary Engle. She is the acting Deputy Director of the FTC's Bureau of Consumer Protection. She has an undergraduate degree from Harvard and holds a JD from the University of Virginia. Ms. Engle.

>>MARY ENGLE

Thank you Bill. Good morning everybody. I would like to thank especially Professor Covington for extending his welcome to us and allowing us to have this event at this facility, which is actually a lot nicer than the facilities the FTC has back in Washington. Hopefully the technology -- since this is the Technology and Public Policy Law Clinic the technology will work better than it does in DC. I want to thank all of the panelists who have come here to share their views on digital rights management technology and the impact on consumers. I would like to thank you in the audience who have arrived and want to let you know that we will have the opportunity several times through several times through out the day for audience comments and questions including as Julie mentioned a whole panel at the very end of the session. There will be plenty of time for us to hear your views as well. And I also want to thank the hundreds of people who have already filed written comments with us and those comments are all posted on the FTC website and we are in the process of reading all of them. One thing those comments do make very clear, and that is that emotions concerning DRM run high. By having this town hall the FTC staff is not trying to take sides on whether DRM is good or

bad. Whether you view DRM as good, bad, or neutral one thing is certain, it does impact consumers. That is the core reason for this event. To help the FTC understand the ways that DRM technology impact consumers and the role they may play and in the rapidly evolving digital content marketplace. Most importantly, to discuss how best to promote informed consumer choice regarding DRM protected goods and services.

Promoting informed consumer choice is a core mission of the FTC. As content owner groups have pointed out in comments to the town Hall, the availability and increasing sophistication of DRM has enabled content owners to provide consumers with an avalanche of choices regarding how, from whom, for how long and in what form consumers access or purchase digital content and how much they pay for it. With this avalanche of choices comes the need to provide clear and effective disclosures of the terms of the bargain. Particularly in the case of Internet delivered content, consumers may be able to discern little about the goods or service prior to purchase beyond what the seller chooses to tell them. Sellers who use DRM technologies must comply with the Federal Trade Commission act when marketing their products and services. The Federal Trade Commission act prohibits unfair or deceptive acts or practices. What does this mean with respect to digital goods and services protected by DRM? Probably the best way to explain that is to talk about a case the commission brought a couple of years ago against Sony BMG. As you may be aware, Sony BMG a few years ago placed content protected software on some of its music CDs without disclosing all of the affects of the software. This prompted the FTC and others to take legal action against

the company. The Commission alleged that Sony deceived consumers by failing to adequately disclose the DRM restrictions on their CDs. It limited the portable devices to which music files could be transferred from the computer and limited the consumers to making three copies of the CD. More over the CD's labeling did not disclose adequately that the DRM software would cause information about consumers' use of the content to be transferred to Sony from consumer's computers. The Commission also alleged that the software unfairly exposed consumers to computer security risks. As part of the settlement, Sony is required to disclose clearly and prominently on the CD packages any restrictions on copying and use. In other words, hard to notice, mouse print type disclosures using cryptic terminology is not sufficient. Now many content owners believe that DRM controls reflect the parameters of the bargain entered into with consumers who have purchased access to their content. That believe assumes that consumers understand what the bargain is. A lesson to be taken from the Sony case is that sellers who use DRM technology to enforce the terms of bargains with consumers need to be particularly careful to disclose in advance all material terms so that consumers can make informed choices. As FTC Commissioner Thomas Rush (ph) said when speaking about DRM back in March of 2007, any material limitations on use rights including, but not limited to technological limitations such as an inability to use the media on another platform must be clearly and conspicuously disclosed before a sale of those media is made. As a market for digital media evolves and becomes even more important for consumers to know and understand the nature of what they are paying for. For sellers

to communicate that information prominently and accurately. Consumers may come to a transaction reasonably expecting to own a digital copy of the work in the same manner they own it in the analog world. A company's marketing materials may only reinforce that expectation. In such cases a company's marketing materials must be consistent with the nature of the product being offered. It's not enough to disclose the information only in a fine print of a lengthy online user agreement. In other words if you are advertising giveth and your EULA taketh away don't be surprised if the FTC comes calling. Although the FTC Act does not necessarily require a seller to dispel every myth or misperception that consumers may have regarding how certain copyrighted content may be used, consumers and content owners alike benefit from clear effective disclosures about DRM. Consumers who come away from a lawful transaction feeling frustrated or cheated because of poorly disclosed DRM limits on content they paid for may be tempted by unauthorized sources of the same content or by tools to break the DRM. Copyright issues aside, the FTC is concerned about the security risks those sources pose to consumers. This problem will only worsen if consumers feel justified, however wrongly, in exploring those other paths. The marketplace may solve many of the problems that the FTC staff has observed and believes may be arising here. However even sellers who do a good job of disclosing to consumers the material terms of transactions involving DRM, protected content will suffer if consumers have bad experiences with sellers who don't do a good job. Content owners are collectively confronting the problem of a mass scale copyright infringement so they can ill afford to

appear like Lucy to consumer's Charlie Brown being asked to run up to try to kick the football. If you buy our DRM protected downloads again we won't shut down the authentication service this time. This type of consumer distress makes for an unhealthy marketplace. We are here today to discuss how providers of digital goods and services can effectively communicate to their prospective customers the terms of proposed transactions and the existence and effects of DRM technologies. If content owners and sellers develop best practices appropriate to the particular type of contents and media they are dealing with and consumers understand the trade-offs and choices associated with different DRM systems, we hope that the FTC will find few occasions to exercise our law enforcement authority. With that, we will get started on the first panel. We have here today just because time is kind of short I will just introduce people's names and affiliations. And I will go back [off mic comment] okay, starting off we have Fritz Attaway from the Motion Picture Association of America. Jason Schultz from the University of California, Berkeley Law School. And Bill Rosenblatt from GiantSteps Media Technology Strategies. [inaudible] Here is the clicker.

>>FRITZ ATTAWAY

In the interest of everyone's intellectual juices flowing first thing in the morning, I will start out by disagreeing with something Mary said in her opening remarks. That is I don't think we can reasonably have a debate as to whether DRM is bad. I think we can reasonably disagree on how DRM is used, but I don't think there can be any question as

to the necessity of using DRM to provide choices to consumers. Without DRM and DRM technology how could we provide consumers with choices to rent it for some period of time or to download of a copy of the movie and permanently all at different price points. We can't do that without DRM. These facilitating attributes of DRM recognized by Congress when it was debating the Digital Millennium Copyright Act and indeed maintaining the integrity of DRM was the principal purpose of the DMCA. The use-facilitating role of DRM has been borne out. At last count there were 62 US Internet services providing consumers with legal content. A vast venue of [inaudible] in addition to content choices over the Internet, consumers also have access to movies, TV shows and other audiovisual material on cable and satellite platforms, on mobile telephones and other devices. Consumers can choose to view free advertiser supported screens, purchase permanent downloads, rent for various periods of time, purchase in various formats a variety of options almost everyday. These options are made possible because of DRM technology. As the technology becomes more sophisticated, options become more abundant. Content owners are well aware of the mantra of today's consumer. They want content when, where, and how, and DRM technology is the tool by which content owners [inaudible] and of consumers. Now, of course, as Mary pointed out, as the DRM technology delivers choices to consumers, we need to inform consumers about how technologies affect them becomes more acute. Fortunately DRM technologies are for the most part transparent. Consumers who purchase a DVD are not surprised they can't make copies for all of their friends and neighbors. Even so the Motion Picture

Industry promotes use of a copy protection awareness icon that reminds consumers they will not be able to copy a movie they have purchased. Unfortunately, consumers are sometimes confused as to their legal rights and what they should be able to do with the content they have acquired. Consumer expectations/legal and market place realities are not only a problem for the consumer, but the content owner as well. Dissatisfied consumers are not good for business. Content owners have a very strong incentive to be sure that consumers understand and are satisfied with the content and content transactions they under take. That video on demand rental, purchase of a DVD or Blu-Ray disk, purchase of an electronic download, via iTunes or any other method. It is in our interest that consumers clearly understand what they get with each choice we offer them. But the need to inform consumers must be balanced with the goals of standing consumer choices and encouraging technological innovation. As DRM technology becomes more and more sophisticated and brings more and more choices to consumers, asking a fully informed consumers how that technology works becomes more challenging. For the most part, I think the marketplace will ensure that consumers are not deceived. Business models that do not deliver the product or service offered consumers and that consumers expect will fail. One of the good things about the age of viewing abundance is that consumers that are dissatisfied with any particular viewing option, can turn to other options that provide greater satisfaction. There may be situations, egregious situations where government, the Federal Trade Commission feels it needs to step in and protect consumers. But the goal of informing consumers should

not be the enemy of standing consumer choices and encouraging technological innovation. I am told my time is up. Oh, okay. I'm sorry. Nonetheless, I think [laughing]

I am through and that is my message and I look forward to the discussion the rest of the day. The floor is yours.

>>JASON SCHULTZ

I will pile on here and disagree with Fritz. We will have a cascading disagreement throughout the day. I will agree with Fritz on a lot of levels as well. That this is an important discussion and I don't think it is as simple as good or evil or any of those kind of dichotomies. I think to me there is a question here around DRM about how do we make it the best it can be in terms of not deceiving consumers and not harming them. On some level it poses a serious threat to a lot of consumer interest and how do we mitigate that threat? It is not like other technologies or products, but it's important to think about it that way. One of the things I wanted to disagree with Fritz on first is this question of whether or not consumers are surprised. It's an interesting question. Are they surprised when they can't copy a DVD? Are they surprised when they can't play it in a different country? Are they surprised when they can't make a backup of it? That's an interesting question and I don't know that we know the answer to that empirically. One of the things about DRM is it doesn't report back when consumers are frustrated. It doesn't phone home and say these consumers are really outraged that they can't do

that. There is a question of how we know. Maybe some of you have seen the recent story about our president giving the gift to the head of the British government, a series of DVDs that would not play on the region player in that country, will see that even the smartest among us would have some understandings about these things. I'm not saying that's an empirical study, but that's an interesting anecdote when the heads of states who are trying to solve all of our world's problems don't actually understand the limitations on their DVDs. What I will talk about are six ways in which I think ineffective notice on DRM can harm consumers. This is very generalized so I will go through as fast as I can. When we talk about effective notice, I think of three things. I will focus mostly on the last two but I want to mention in terms of goals. I think we have to really think about how to meet or establish consumer expectations. This is where I agree with Fritz if consumers understand what they are getting and the value proposition that is a good thing. That's probably the best thing we can hope for in this market. It is a tough goal to reach and we can talk about that later. The second thing though and I want to focus on that is lowering information costs. That is so that the consumers do quickly and efficiently understand what they are getting. There is a lot of information that comes with DRM and information in the user agreements, a lot of information in the different technologies. Can consumers understand that quickly without high integration costs? And the third thing is to talk about the unique risks that DRM poses to consumers and the kinds of harms that Mary highlighted around the Sony case. They are little different than some products that consumers see in the market. So really

quickly why does information costs matter? From a basic economic perspective, if a product has a value say \$15, it is a good deal for me if I can get that value for a price that is lower than the value that does not include huge information costs. If it cost me \$10, it's worth \$15 to me and the information costs, the time and energy it takes me to figure out what is going on is also costing me \$10, then I am spending \$20 for something that is only worth \$15. That's not a good deal for me. When information costs exceed the value of the product, there is a market failure. Generally what we see from the studies is that consumers either don't bother with the information costs, they don't read, don't care and a blast right through it and buy the product hoping they want it or they don't buy it. To me that is a market failure. That's why we need to focus on this. There is an example of this in the privacy policy market. There was a great study done by Carnegie Mellon where they looked at privacy policies. Many of these privacy policies are over 2500 words and they did a study that said that if every single internet consumer read every single privacy policy of the major websites they visited in a year, it would take on average 200 of their hours to read those privacy policies and cost them in terms of their own time \$3,000 per consumer. You can see the value proposition is impacted by the information cost depending on how much we expect consumers to read. That is aggregate. If you buy an iPhone and you agreed to all the EULAs, all the terms of services; iTunes, iPhone's marketplace, the Web server one, the iTunes client, AT&T terms of service, that is over 22,000 words that you have to parse. For things like 99 cents iTunes purposes is an \$3.99 apps on your iPhone. I will talk about this very

quickly which is that there are three information costs in the DRM market that I think are important to focus on. One is as has been mentioned limitation on use or transfer of things I associate with the object value. I buy this object, what is the value to me. Limitations on interoperability which are the value I get from this object being part of a greater network. Whether be other devices or services or the Internet or my friends or Facebook or whatever. Three is also around the issue of discontinuation or service or continuity of service. Can I figure out the information costs and the risk I'm taking there? As I mentioned, the first one is what can I use this on and how can I use this and the use limitations transfer problems. Here I mentioned that if the information costs are very, very high and the product costs are low that it depends what my value is for that product. You can see that high information costs can thwart the market here. So consumers either not buy or not read. Interoperability concerns, this has also been discussed in length in the iTunes context and the other context in the Sony context about what you can play it on. This is a graphic from the back of one of the Sony CDs that were sold. You can see that if you are someone going into a music store and you are seeing that I will buy this music, I like it, it is \$9. But I have to read this. How much does that add to my costs? Does that exceed the value of the product? How do I understand this and incorporate it into my decision-making? Finally, and this has been dealt with in other context. Discontinuation of service and the problem that poses. I will kind of whiz through this a little bit. In terms of the risks that are posed outside of the value proposition, the additional risks. This was talked about in the Sony case. You have

security and privacy and legal risks. When we can see in the Sony case and also with the World of Warcraft you have things where consumers have to predict what risks will be to their security and their privacy if there's a phone home feature. Those are difficult risk for most consumers to take into account. Many of them are not technical or legal experts. Finally also on number six there are the legal risk of violating the DMCA.

We've seen a number of lawsuits or threat letters where consumers themselves are often -- consumer generated innovation, trying to add on or modify their own products have run afoul of legal restrictions and legal risks to them that DRM poses because of the DMCA and anticircumvention regulations and the liability that can impose on them. Just to sum up, these other six harms. I know I went very quickly, but I wanted to lay them out. The first three are around the information costs. The last three are around what I consider unforeseen or generally hard to predict risks for consumers about DRM in particular. I know we will talk a lot about disclosure and labels so I just wanted to end on this slide and say that I think if labels will help, then I think they will have to do these three things. They will have to help meet consumer expectations, lower the information cost dramatically so that consumers get the value for that thing they are buying. And then they will have to effectively warn or prevent these additional kind of risks to individuals. Security, privacy, and potential legal liability under the DMCA. Thank you.

>>BILL ROSENBLATT

Good morning. Let's see, there I am. I would like to thank the Commission for inviting me to speak here this morning. I am a consultant. I try to play the role of the informed moderate. [off mic comment] The extremes. I love one thing that Jason just said, the smartest among us might have some misunderstandings about these things. There is a lot of that. The type of misunderstanding that bothers me the most is when people don't understand what DRM is versus what it is not. I saw Jason's list of objectives of labeling and feel that they are a very tall order and very difficult to capture because they are very ambitious and conceptual. I will try to take the opposite tact here and explain in empirical terms and in a short amount of time to be expanded on in the hallway later or whatever. What do DRMs actually do that consumers would care about at a basic level? Taking the opposite direction. And then briefly what are the trends for each of these elements of DRMs? So, here are the four things essentially that DRMs govern. They govern devices, they govern identities and authentication and I will talk about what each of these is, they govern extents of usage of content and they govern information about consumers' usage of content. Devices. There are four types of devices that we see nowadays. There are PCs and Macs, tech devices, connected portable devices or home devices such as iPhones or DVD phones which are video broadcasting phones, e-book readers, IPTV, set-top boxes and so on. There are devices that are more dependent such as your iPods or Sony readers or other music players that you depend on your PC to get or Mac to get music or video from or e-books from. There are physical media products such as DVDs, Blu-Ray discs and so on. Four different types of devices that

DRMs may pertain to. The trends are that consumers are getting more devices, they are using greater network bandwidth with those devices or there are more devices that are connected versus not connected. Users are getting -- trading in their devices more frequently. It is not the case anymore that you have your one device and you stick with it for a while. Consumers have more and different devices over time. There are also more trends in physical media that are coming up with huge bandwidth such as USB 3.0.

Authentication and identities. There are three things you can identify and authenticate; users, devices, and domains which are groups of devices such as all the devices that a given user owns and they can be limited by number or by geographic proximity and these three can be combined DRMs. That trends are domains are getting more popular, but the rules about them can be very complex. They are all about consumer electronics manufacturers trying to establish their platforms in the marketplace. There is a trend known as right lockers where a service provider will keep track of what rights you have on what the devices. And then there is this issue of is the authentication done locally on the device or does it require communication to a server somewhere. Extensive usage, this is more familiar territory for a lot of people. Rentals, purchases, subscriptions services, like Rhapsody for music, library lending of digital works. And then there is the idea that you can control the number of copies or burns or how many PCs you can you view this on or what ever. The trends here subscription services are slowly building a following. Libraries, public libraries are doing e-book lending. That's a big trend. There are these managed copy rules for Blu-Rays and soon DVDs are expanding in terms of

managed copy capabilities. There are video rental terms that are out there and movies studios are starting in various places to compress their release windows meaning there are terms involved with that that consumers need to understand. Usage information is either collected on a device or it is sent -- not exclusively it could be collected on a device, it could be sent to a service provider, it could be required information so that the rights holders get compensated for usage in certain models or it could be used for marketing purposes, hey, we see you like this artist and we bet you would like this other artist. Things like that. Or here is a coupon for a T-shirt or what ever. The trends here are if you subscribe to a service like a Rhapsody or a Cinema Now that has a subscription to movies, it is expected that your usage will be recorded because the rights holders need to be compensated. Otherwise any type of usage reporting particularly in an ownership situation is considered a no-no as far as consumers are concerned. Some of this came up in the Sony BMG protected CD case. I would like to conclude this rapid tour of the things that I think consumers ought to know about with regard to DRM systems. I put a poll up on my blog, copyright and technology .com just for fun. This is not a scientific poll and I am not a qualified market researcher. I asked the question, in abbreviated form "How should the FTC regulate disclosure of content services that use DRM?" There were four choices. How many people saw this poll just out of curiosity? A few people. There were four possible answers. The first one was mandatory disclosure in detail, like a food ingredient or a nutrition list on a food item. Mandatory disclosure at a high level like a restaurant menu item. It says roast chicken, but does not

say it comes with 3.5 ounces of potato and four spears of broccoli and so on. A logo or rating systems such as the MPAA uses for film ratings where -- or you might say the Homeland Security Department uses for threat levels. Or just keep it voluntary. The results were 39 percent said it should be mandatory and in detail. 31 percent said it should be mandatory at a high level. 15 percent said there should be a logo or rating system. 15 percent said to keep it voluntary. I attach no analysis to those results. Just thought that they might be interesting to show. Thank you again for having me come and speak here. I will stop there.

>>MARY ENGLE

Thanks to the panelists that we actually have a little bit of time left for questions.

>>MALE SPEAKER

Can we have my two minutes that I did not use?

>>MALE SPEAKER

Thanks Mary. This is not a rebuttal. Jason I agree in most part with everything you said. What you said tends to illustrate the last point I was trying to make which is what I want to emphasize now. An illustration is the fact that you all know that consumers would like to take the movie DVD that they buy and play that DVD on other devices like a cell phone or handheld devices. Studios are now providing that option. In order to provide

that option at a cost that the consumers can afford and is willing to pay, they have to restrict copying, so you don't make copies for all of your friends and family and neighbors. The DRM that does that is very sophisticated and kind of complicated. Jason you are absolutely right that the cost of informing consumers as to what they can and cannot do with this new option is relatively high. Some consumers are not going to fully understand. Does that mean that consumers should not be given that choice? That is the point I was trying to make. The goal of fully informing consumers which is a perfectly valid goal and a goal that I support, should not be the enemy of providing consumers with options they want and encouraging technological innovation. That is the policy issue that I think we are all here to discuss.

>>MARY ENGLE

That's right. I think that our third panel this morning will be discussing that issue. [inaudible] and I think Jason you mentioned [inaudible]. Is anybody aware of any empirical research on this issue [inaudible]?

>>MALE SPEAKER

I have seen a few studies. There were a couple of studies and if you had asked me this question yesterday I could have looked them up actually. I could have looked them up last night. There were a couple of studies done over the last year or two in the UK by a market research firm whose name I would have to go dig up. They showed -- this was

about how necessary do you think DRM is and are you aware of the restrictions, how much does that bother you and so on. If I remember correctly the results were surprisingly evenhanded. They were significant -- I will go dig up the results and we can -- I would rather not risk misrepresenting them right now. There have been some studies done that I thought were illuminating and certainly more scientific than the one I showed here.

>>MALE SPEAKER

I will just add to that very quickly. In addition to the privacy policy study the clinic at UC Berkeley has also helped with a number of studies around end user license agreements, EULAs in terms of service. Not that any -- not that any particular term is clear or not but about the information costs associated with the amount you have to read and I think what we can see is that the more you have to read and understand, the less you actually understand. Which is sort of sad. I think the evidence is also showing that keeping it simple is the key. This is one of those conflicts which I think you have which is you want diversity in the marketplace, but as you have diversity in the marketplace you also have higher information costs. It is just a tension right. If I go to the grocery store and I can buy a soda for a varying price and brand. That's easy for me to understand, it can be 50 sodas. But if every soda came with a EULA that I had to read and each EULA had different use restrictions on where I can drink it than the price of the soda starts to be the last of my concerns. That's also part of what the studies are showing is that what

consumers understand is not only about the substance, but the length and the form of the information as well.

>>MALE SPEAKER

You have to bear in mind that Coke and Pepsi have figured out how to label their products so that the key nutritional or psychotropic information is featured.

>>MALE SPEAKER

Just to add to that very, very quickly I think that [laughing]

>>MALE SPEAKER

It's gotten violent already.

>>MALE SPEAKER

A little too much coffee this morning [laughing] But also what are the dangers to consumers and this gets back to Fritz's point too which is that I think we can have a debate about what kind of an informed policy we want in terms of informing consumers, but I think we also to think about that relates to the kind of harms you're trying to prevent. Information about can I play this product here or there is useful information, but it may not be about protecting consumers against a particular kind of security risk or privacy risk or something else. If a car will blow up, that is much more important as a policy

matter then what color it is perhaps.

>>MARY ENGLE

Okay, thank you. We are out of time. [applause]

Moving on now to our second panel which will discuss the legal landscape. Our moderator for the second panel will be Carl Settlemyer, an attorney in the FTC's Division of Advertising Practices.

>>CARL SETTLEMYER

Good morning everyone. Thank you for being here. I would like to welcome you to the stage while we are changing over five of the six distinguished attorneys who comprise our legal landscape panel this morning and I think nametags will be set out and fresh water and so forth. Let me just tell you the names of these folks. First by teleconference we will have -- by videoconference we will have Rob Kasunic, a principal legal advisor US copyright office. Live and in person we have Steve Metalitz, an attorney with Mitchell Silberberg & Knupp, who represents a number of content industry associations. Corynne McSherry of the Electronic Frontier Foundation. She is an attorney there. Justin Hughes, Professor, Cardozo School of Law. Salil Mehra, Professor, Temple University Beasley School of Law. And Nicolas Jondet, a PhD candidate at Edinburgh Law School. This panel will discuss how copyright, contract and

Consumer Protection laws can converge when consumers buy and use DRM protected content. We have six panelists. A tight schedule. Diana will be keeping everyone to eight minutes so we have time for questions from the audience here and people watching via the webcast. If you want to e-mail questions from cyberspace please send to DRMtownhall@ftc.gov. We also have microphones here in the room so at the end of the panelists presentations you can line up at the microphones or if you are too shy to do that, you can hand a question card to Julie and Katie who will be collecting cards to bring up to us to ask questions. Now before we get -- before I turn things over to the panelists, I will talk to -- everybody make sure you speak directly into your mic so we can minimize any audio problems. We want to make sure that we are not shutting anybody out -- but don't touch them! [laughing]

Just be gentle. We maybe have some tech people around who can help adjust those as things go on. Before I turn things over to the panelists to talk, I will talk for three minutes about copyright law. The Copyright Act is a complex federal statute that runs hundreds of pages. Skipping more than a few details, here are some of the core concepts for today's discussion. Copyright law is fundamentally about the rights and creative works, like literary, musical, pictorial, and audiovisual works. As a song is to notes and words, written on paper or recorded on a hard drive, works are intangible things recorded in tangible things that allow people to perceive the works directly or with the aid of a machine. The copyright act provides that authors of creative works fixed in any tangible

medium of expression like, paper, film, DVDs, or computer hard drives have certain exclusive rights with respect to those works. These rights can come into existence when the work is first fixed, when the author puts down his or her pen or stops recording. The ownership of any exclusive rights under the Copyright Act is distinct from ownership of any copy of the work while fixation is necessary to create a copyright interest, after fixation the exclusive rights or copyright are intangible and apply both to the intangible work and copies of the works. These rights last for the life of the author plus 70 years or up to 120 years from the creation of a work made for hire. Copyright protection does not apply to ideas, processes, concepts, discoveries or facts, but may protect particular ways of expressing or of selecting and arranging them. US government works are not protected by copyrights and feel free to copy the agenda and Mary's speech until your heart is content. These works and works on which copyright protection has expired primarily those published before 1922 are considered to be in the public domain. The Act says that subject to its sections relating to fair use and other limitations, a copyright owner has exclusive rights to reproduce works and the working copy, prepare derivative works based on or adapt the copyrighted work and distribute copies to the public by sale or other transfer of ownership or by rental, lease, or lending. To perform the work publicly, display the work publicly, and perform sound recordings by digital audio transmission. The fair use section of the law allows in appropriate circumstances persons other than the copyright owner to do those things for purposes such as comment, criticism, teaching or research without getting the copyright owner's

permission. Multiple factors must be considered in the complex assessment of whether any given use of a work is a fair use. That's all I have to say about that.

Notwithstanding -- I'm sure some of the panelists will expand on that. Notwithstanding the copyright owner's exclusive distribution rights, the owner of a particular lawfully made a copy can without permission from the copyright owner, sell or otherwise dispose of the possession of that copy. This is known as the first sale doctrine or maybe the yard sale doctrine, depending on where you grew up. It primarily limits the copyright owner's distribution right not the other exclusive rights. But the first sale doctrine does not extend to any person who acquires possession of the copy without acquiring ownership of it. It does not apply to a loaned or licensed copy. The copyright owner's exclusive rights can be transferred in whole or part licensed on an exclusive or nonexclusive basis and divided, subdivided and combined in an infinite number of ways so multiple parties may have various combination of rights in any given work. Copyright owners can sue in federal civil court actions people who infringe their exclusive rights. Remedies can include injunctions against further infringement, actual money damage awards, or statutory damage awards ranging from hundreds to hundreds of thousands of dollars. The loser of the case might be ordered to pay the winner's attorneys fees. Ten years ago Congress augmented the Copyright Act for the digital age. It passed the Digital Millennium Copyright Act or DMCA which Rob Kasunic of the US Copyright Act will explain presently. Rob are you there?

>>ROB KASUNIC

I am. Can you hear me?

>>CARL SETTLEMYER

Yes, we can. Let 'er rip.

>>ROB KASUNIC

Carl did a great job summarizing some of the key features of the 1976 Copyright Act. I don't think I've ever heard it done in three minutes before, but it was done very well. I will continue with the development of the law into the digital realm. And discuss a little bit about the Digital Millennium Copyright Act. With the advent of digital technology and the Internet, Congress was persuaded that an amendment to the basic principles contained in the 1976 Act was necessary. That amendment came about in the Digital Millennium Copyright Act. Clearly society has benefited from significantly from digital technologies, but the capabilities of these technologies posed fundamental problems for copyright law and the creators of copyrighted content and the creators that copyright is intended to encourage. There has always been a symbiotic relationship between the developments in technology and copyright law. In fact copyright law has its origins in response to the development of technology, namely the printing press. Since its creation, copyright law has generally expanded or changed to address the changes in technology. I will switch to my PowerPoint slides and hopefully you can see that. Since

the beginning -- I don't have control -- since the beginning of digital technology and computers non-legal rights and permissions have existed for access and modifications of computer files. Going back to the days of mainframe computers, the assignment of rights and permissions associated with files determined who was allowed to access particular files and who could modify or delete those files. As digital technology developed in the personal computer area, computer software companies as the first creators of digital works used a variety of technological measures to restrict access to copies of works and prevent unauthorized copies of works from being created.

Measures such as passwords, serial numbers, encryption and other forms of protection were used as ways to impede unauthorized use and copying of files without any form of legal protection. Just the technology itself. Such defensive technological measures were deemed necessary because personal computers eliminated many of the practical limitations on copying. Traditionally, copyright law was supported by the practical constraints on the ability to copy. As advances in technologies of reproduction and dissemination eliminated those practical constraints, the law alone was not sufficiently effective in preventing infringement of the exclusive copyrights of the copyright owners. Similarly defensive technological measures had limits. Passwords and serial numbers could be hacked and distributed to others. Black boxes could be sold that decrypted encrypted cable signal. For every technicalological measure created to protect works, a counter measure could be made to hack through the protection. A technological arms race of this sort was destabilizing to a market for copyrighted works. Congress

determined that the solution was to provide legal protection to the technological protection measures used by copyright owners to protect their works. In addition to stabilizing the market, Congress believe that such legal protection would promote what it terms and what Fritz referred to earlier, use facilitating business models that would be beneficial to the public. By this, Congress envisioned that rather than buying a digital work out right, users might instead be able to pay for time-limited access to a work for a reduced price. Or instead of purchasing an entire work or database, users might be able to select portions of works that they wanted to use at less than the cost of the whole work. Our current business model of streaming access for full catalogs of music for a monthly fee, digital downloads of individual songs rather than purchasing entire CDs or pay for view motion picture access as an option instead of buying DVDs or traveling to a store to rent a DVD are all examples of the development of these use facilitating business models. Now Congress in enacting the DMCA bifurcated its treatment of technological measures into two general categories. First of all it considered that there were technological protection measures that could protect access to copyrighted works and then there were technological protection measures that could protect the individual rights of a copyright owner. Those Section 106 rights of reproduction, adaptation, distribution, public performance and public display. Section 1201 also created prohibitions for two general types of activities. Circumvention of technological measures that protect access to works and trafficking in devices or services that circumvent access controls or measures that protect the exclusive rights of the copyright owner. Putting

these two different distinctions together, I found it helpful to approach section 1201 by looking at these quadrants. In the upper left-hand corner is where we find section 1201(a)(1) which is the anti-circumvention provision. The provision that prohibits individual circumvention of measures that protect access to a work. That would prevent hacking, the encryption or passwords or serial numbers that are placed on a copyrighted work to limit access to authorized users. This may come about just in terms of a website that has a password protection on it or a database that has password protection on it. If someone hacked through that measure that password to get into the website, that would constitute a violation of Section 1201(a)(1). Under the 1201(a)(2) in the lower left-hand quadrant is the provision that supplements 1201(a)(1) and prohibits trafficking in devices that would circumvent measures that protect access to copyrighted works. This would be if there is a website that is providing those passwords or serial numbers to users to enter into circumvent the access protections or providing the black boxes for instance that would descramble encrypted programming. So that the trafficking provisions supports the circumvention provision or access.

>>CARL SETTLEMYER

Rob this is Carl. Just to let you know, we will need to have you wind up in about two minutes. So --

>>ROB KASUNIC

What Congress did not do is create a prohibition on circumvention for measures that protect the rights of copyright owners. In that upper right-hand quadrant there is no comparable prohibition to what is contained in Section 1201(a)(1) and that was the provision that Congress intended that was covered by traditional copyright law and Congress intended that if people -- users wanted to make fair uses of works even if there was a technological protection measure protecting the right for copyright owners, the user would be free to circumvent that measure that was controlling use rights if the underlying use was a non-infringing use. One of the uses that would be covered by the limitations in Sections 107 through 122 in the Copyright Act. What it did do however is provide a prohibition in 1201(b) on trafficking in devices that would allow people to circumvent those use controls placed on copyrighted works. That is something I think that Corynne may be talking a little bit more about in a little bit. So one other thing I just want to make you aware of is that in addition to the absence of a prohibition for circumvention of measures that protect rights of a copyright owner, Congress also created a failsafe mechanism in the rulemaking that is carried out every three years by the copyright office. That rulemaking is to determine whether users engaging in non-infringing uses of copyrighted works have been or are likely to be adversely affected by the prohibition in section 1201(a)(1), that upper left-hand corner quadrant that I just showed you. The Librarian of Congress may create exemptions to that prohibition for particular classes of work for each ensuing three-year period based on the recommendations of the register in the 1201 rulemaking. And finally, just for you to look

at your leisure, the entire record for that rulemaking is available on the Copyright Office's site. We are currently engaging the fourth tri-annual rulemaking as we speak. The record for all of the past rulemaking, 2006 rulemaking as well as 2003 and initial 2000 rulemaking are available on the Copyright Office's website for you to take a look at further. I will leave it --

>>CARL SETTLEMYER

Thank you. Great. That was terrific. Very condensed, informative discussion DMCA. It trumps my three-minute copyright summary. I will turn things now over to Steven Metalitz who will talk about the types of transactions that consumers enter into and the content owner's perspective on that subject.

>>STEVEN J. METALITZ

Thank you very much Carl. I appreciate the opportunity to be here and thank the FTC for this invitation. This panel is entitled the legal landscape, copyright, contract and consumer protection. I will try to touch at least on all three of those bodies of law. On copyright I think between Carl's summary and Rob's summary there is not a whole lot left for me to say about the copyright landscape. Let me just stress one point that Fritz Attaway brought up. His slide had a clearly excessive amount of text on it. The information cost of reading that were certainly high. If I can just boil it down. It is clear that Congress when it enacted the DMCA, Section 1201, Rob has explained what they

did, but let's emphasize why they did it. Congress anticipated that these technological protection measures which maps more or less to the DRM we are talking about here, that it would be use facilitating, increase consumers access to copyrighted works. A tool to promote e-commerce in copyrighted works. There would be more use of the Internet for example, to carry out that and that it would be a flexible tool, one that would be responsive to the changes in the marketplace. Now 11 years later we can look back and say Congress was correct. My view -- if you go back and look at the records of DMCA rulemaking procedures where they have been intensively studied every three years for the last decade, you will see that the use of access controls at least one important category of DRM has contributed very significantly to more access by more people in more ways and to more material protected by copyright than ever before. It has enabled a lot greater flexibility, consumers are no longer faced with a binary choice of full permanent access to the material at a full and high price or virtually no access at all. An economist might call this diversity that Fritz outlined and other referred to a form of price discrimination which I suppose it is. I will call it offering more choices to consumers. That is really the point that Mary Engle emphasized in her opening comments. This avalanche of choices. I would prefer to look at it a little more positively and refer to a cornucopia of digital products and services that consumers still have available, but DRM which is continuing to evolve as it does so these choices tend to broaden and consumers have yet more means of accessing this material. Finally DRM has encouraged right holders to make more and more content available through all of these

different channels as Fritz indicated. What is the significance of this to the town hall and the legal landscape? It does make a difference whether we approach DRM as good or bad. I would take the view it is not a necessary evil that should be limited and circumscribed to the greatest extent possible and we should focus on the harms that could follow with it. Instead it is a key enabling technology and helps to empower consumers and bring more competitors to the marketplace. It should be encouraged. That's what Congress said in the DMCA. Congress is the source of federal consumer protection laws as well as copyright laws. It's important what Congress has found in that area. It is also very relevant to these Consumer Protection issues. If you approach DRM as a bad thing you will be looking for the skull and cross bones or the Mr. Yuck symbol for poison or some other type of onerous disclosure. Instead I think we should be trying to keep transactions that involve DRM as transparent and simple as possible while still that the adequate disclosure to consumers. Let me talk a little bit about disclosure. It is worth mentioning that Congress did address this in the DMCA. There is an exception to the prohibition on circumventing access controls that applies if a DRM collects personally identifying information on an online consumer without conspicuous notice. In that case the consumer can legally circumvent to defeat that data gathering capability. That provides an incentive with the DMCA itself. If you had a DRM that was collecting this information and as Bill's presentation earlier indicated, that is one aspect of some DRM systems. There is an incentive to disclose those capabilities. Congress was anticipating part of this problem. We have not talked about what the standards are

that the FTC applies in enforcing the prohibition on unfair or deceptive practices. I am no expert on that, but my understanding is that you have to look at whether there is a representation, omission or practice that likely mislead the consumer acting reasonably in the circumstances to the consumer's detriment. This is a concern to copyright owners. They recognize that this obligation exists and take it seriously. There have been some industrywide steps and Fritz referred to the logo that is placed on DVDs. In other cases, individual companies are experimenting with different means of disclosure. Just as there is very wide experimentation in business models, in fact experimentation is one hallmark of this market. Something that we should be encouraging and not discouraging. Let me just mention a few other factors and line up the disclosure issue with the FTC's mandate. First we have to be aware that one size does not fit all especially when you are talking about the difference between online delivery and hard goods. The product package has a finite amount of real estate. You know what space you have to convey the information that is needed. In an online environment it could be different. You could have links or pop ups although they bring other problems with them. Advertising is different online or off-line. That is one factor to take into account. Also one size does not fit all as far as particular products and services. The audiovisual material distributed has never been distributed to consumers in a hardwood format that allows unlimited copying or platform shifting. Thinking back to VHS era and from there onward. On the contrary many of the formats used to distribute recorded music were capable of such uses. If you look in the software sector, there have always been

limitations on the number or kinds of platforms on which a program can be used. That has been true throughout history and that will affect consumer expectations. They will be different because of the different histories. Let's talk about consumer expectations. We will hear a lot today about that. We have to be careful to examine the basis of those assertions. I represent companies that live or die based on whether they meet the expectation of consumers in the marketplace or not. These companies have a very strong incentive to calibrate these expectations accurately and realistically to deliver. That does not mean they always get it right. Sometimes they get a spectacularly wrong. But when they do, the market punishes them. There is a strong incentive to get it right. If you have a narrow focus on whether or not a particular DRM system allows a particular use of copyrighted material, I think we are focusing too narrowly. We should be looking at the overall expectation of consumers. Are they getting good value for the money they spend on access to copyrighted works? I think we should all have to recognize that events like this one, are not just assessing or describing expectations, they play a role in setting expectations. Let's play that role as responsibly as we can. Sometimes in the background and sometimes in the foreground, we hear persistent drumbeat that DRM is bad because it is taking away the rights that consumers have under copyright. We hear references to the rights to make backup copies or format shift or platform shift. This is a useful rhetorical device, but it can be very misleading and I would almost say deceptive, but that is a term of art in the FTC world. Our previous speaker knows that better than anybody else. There is a lot of what the copyright office

has had to do year in and year out in these tri-annual rulemaking proceedings is to explain that some of the broad rights that are asserted really don't exist and the court has not held that those are rights protected by the Copyright Act. Let's talk about what disclosures are reasonable, but let's be careful about inflating expectations unreasonably through irresponsible or inaccurate rights talk. I see I am out of time so I can't really get to the third issue of contract. I'll -- maybe we'll reserve that for [overlapping speakers]

>>CARL SETTLEMYER

We will turn things over now to Corynne McSherry from the Electronic Frontier Foundation. She has some PowerPoint slides. Let's see if I can bring them up. Here's the controller. Fire away.

>>CORYNNE McSHERRY

Thanks very much also for having us here and inviting the EFF to come and speak. Actually in the spirit of this panel I will have to get up right here and disagree a little bit with Steve. I actually do think there are some user rights and I want to talk about them and whether they are being met and I also think there is a little bit more to say about the legal landscape. I will start by doing that. Let me start with the proposition that you don't hear enough if you ask me which is that copyright law is not just about protecting the rights of owners to use and manage and control all distribution of creative works.

Copyright law has historically been about a balance between the rights of copyright owners and the rights of the general public to use copyrighted works. When that balance works well, it promotes new creativity and innovation and free speech. That is the balance we always want to accomplish. Unfortunately DRM all too often can upset that balance and that can be harmful to consumers and innovation. Let's talk a little bit about user rights. There are some user rights enshrined in the Copyright Act and the first of them is fair use. That is probably the most famous one. I think that consumers have a whole series of expectations based on the fact that we have long had a fair use rights enshrined in our common law and the Copyright Act. Fair use means that you can do things like buy a CD and take it home and play it on various different devices and play it in the background in your kitchen and your toddler can dance to it and then you can put a video of the toddler dancing up on YouTube. Fair use protects all those kind of basic personal uses and I think consumers expect and rely on their fair use rights even if they have not memorized Section 107 of the Copyright Act. They have a background expectation that they will be able to do all kinds of things with the content that they buy. Unfortunately DRM can interfere with those expectations in all kinds of ways. That's not where the interference with fair use ends. It's not the effect on users, it is also an effect on innovation. I think another thing that consumers expect and especially people that have been following the development of music technologies over the past decade or so, they expect that they will have new uses and new tools. They expect when they buy content down the line, some new technology may come up that

they will be able to or they might want to interact with and they won't have to repurchase that content every time a new technology comes along. I think people have developed that expectation, as they should. Unfortunately DRM can interfere with the development of those new technologies. I have just pointed out three examples, there are many, many examples where new technologies have come under threat because content owners have argued that the new technology interferes with the DRM and then have used the DMCA to bring claims against that technology. I will point to one that is particularly important which is Real DVD. That is a new technology that would allow users to make backup copies of the DVDs that they purchase. The thing about it is that Real DVD did its best to play by the rules. They went to the consortium, there are two consortiums that manage the DRM for DVDs. You have to get a license from them in order to play in that market. That means that you have to go to your competitors and say with hat in hand, can I have a license for my new technologies. It allows major players to have effective veto power over many kinds of new technologies. Real DVD tried to play by the rules, they went and got a license and built a technology that enabled folks to make fair uses of their DVDs. A reasonable backup copies, perfectly reasonable thing. Tried to put that on the market and they were stopped and immediately sued. They are now under a TRO to prevent them from marketing this technology. Here is a company that played by the rules and tried to offer new choice to consumers and do it legally and straightforwardly and was unable to do that. Therefore consumer choices are now being limited. As a practical matter there are alternatives that are not licensed

that are out there right now. These guys were trying to play by the rules. Very quickly there is another right that users have and that is for sale rights which Carl referred to earlier. Consumers have an idea that as Jeff Bezos of Amazon put it, put the right very succinctly, with respect to books, if you buy a book, you will have the right to resell that book and lend it out and no one can stop you from doing that. Everyone understands this is what Jeff Bezos said in 2002. But now, sadly Amazon is marketing the Kindle and the Kindle does something very, very different thanks to DRM. The Kindle is an e-book device that allows you to only play specific content that you can purchase from Amazon on this specific device from Amazon. So if someone sold you a printer and said you can only print out certain kinds of documents on this printer. And no others. They have in fact have sued people or threatened people with the DMCA claims who are trying to import content, non-Amazon content onto the Kindle, again without even messing with the DRM but they are making DMCA claims against the folks that allow that. And props to Mark Pilgrim for pointing out this contrast. We spoke earlier about the problem of abandonware when services are shut down. This is a related issue. I think people, even when there is some disclosure in advance when people sign up for music services, for example, they have a notion that they are actually buying content and getting something that they will at least be able to keep in a persistent way. When DRM servers are shut down as has happened many times in the past year in particular, suddenly consumers feel that they have been abandoned and I think if people think they should have known that going in, surely didn't they read the license agreement or didn't they know that. The

uproar that we saw in response to the Yahoo! music shut down, the MSN music shut down, the Major League Baseball shutdown tells us that in fact consumers had very, very different expectations about what their rights were going to be. Finally, I know my time is running out, what this sort of implicates is the other part of the legal landscape which we have not talked about a lot which is contract law. The DRM is backed up not by the DMCA, but by end user license agreements. As we have seen and we saw in the Sony BMG situation those license agreements can be long, the information cost can be very high. Here is the first page by the way of the Sony BMG. Second page, third page, fourth page, finally last page. Now, the information cost of reading that, let me tell you personally I happen to know are high. Underneath all of that legalese we call this at EFF the legalese kit because there was a lot snuck into those things. Rules about whether you could bring your music to work. Rules about whether you could refuse updates or not. Rules about whether you could leave the country with a digital copy of the music that you had lawfully purchased. The CD that you had brought home. Rules about reverse engineering. And where any of these rules disclosed in advance? Would you know about them? All you would know, as Jason pointed out, all you would see is this little symbol right on the back that says -- you can't even read it, use applicable to end user license agreement. You know when you buy the CD that's all you get. Then you go home and you put the CD in your computer and all that legalese would pop up. Then you would know. That's a problem. Let me close by suggesting that -- three things. One is I don't think user expectations with respect to the law and DRM are based on the

DMCA anyway or on rules I think they are based on long-standing principles like for sale and fair use. One proposition. Secondly, I think what the Sony BMG EULA tells you that much more useful if we're going to talk about disclosures what we need are disclosures in advance. We don't need disclosures that are going to pop up when you put content in your computer when you bring it home. There are two things accomplished by that. One is that it allows consumers to themselves get informed, but it also allows proxies like EFF and other consumer organizations to look at those disclosures in advance and explain them to people and help folks understand what they are buying before they buy it which again will allow them to make informed decisions. The final thing I would say is that, at the end of the day, a disclosure would be a good thing, but we all have to be honest. Disclosure is not going to solve the problem with DRM. Disclosure will help consumers better understand the problems with DRM. That would be a good thing, but it won't be enough.

>>CARL SETTLEMYER

Thank you Corynne. Let me turn it now to Justin Hughes.

>>JUSTIN HUGHES

Thank you Carl. First I want to thank the FTC for inviting me and Karl for all his efforts in organizing the day's events. I'm especially appreciative of this effort because DRM and law professors have never been a good combination historically and I have already

heard a lot of discussion here that is a lot more nuanced and at different levels than you typically heard in the first few years of academics and advocacy groups talking about DRM. Jason, I was stunned to hear that all the iPhone terms of services and EULAs constitute 22,000 words, but then I realize that's just a short law review article and though what is the problem. [laughing] Then I realized also that newspapers are shutting down around the country because people are busy reading terms of service. [laughing]

Anyway, in the early days, in discussions about law and DRM law professors warned everyone about a cultural and informational environment that would be locked up or locked down. You could choose whichever prison metaphor you liked the best. It is pretty clear that that is not the world we have ten years after the DMCA. We have a world full of digital locks but a world that is not characterized very well by much digital lockdown. A decade after the DMCA and almost as long as after the European Unions Copyright Directive, I think we can start to have a better perspective of understanding DRM in ways that we did not and problems we did not, problems it generates for consumers, what we've done in the past and what we can do in the future. Now Steve mentioned that there was a part of the DMCA that addresses circumvention or the capacity to circumvent in a case of -- I thought that was the cookies issue. Are you speaking of the cookies exception? The reason I characterize it as the cookies exception is we had no conception of a lot of what DRM does today when that was drafted. In fact, when the DMCA was drafted there was not much discussion at all about

disclosure regulation or information regulation. And I have very vivid memories of a lot of the negotiations of the 1201 provisions. I have to say that what we are talking about today, and we need to be clear about talking about it, and many of the comments submitted to the FTC break into two groups which Corynne highlighted in her remarks. That is are we here to engage in substantive regulation of the marketplace or are we here to engage in information regulation and disclosure regulation? Are we here to clear the information markets and allow the substantive markets the allocation of rights to be determined by the parties and if we are here to do that, we do have major problems of full disclosure, adequate disclosure as Mary said consistent disclosure and then of coarse information efficiencies in that disclosure. But we also might be here to talk about substantive regulation. Let me talk -- and I think Corynne you are here more to talk about substantive regulation in the sense that by her remarks she is most interested in securing rights and securing an established relationship between the parties between the content providers and the consumer. Those are very, very different regulatory objectives everyone. We need to be clear about what we want to focus on and what we think we can achieve. Now let me talk a little bit about the DMCA as a kind of a lessons of the legal landscape as an attempt at substantive regulation. There is no question that it is a form of substantive regulation. I have to talk a little bit about a paper that was published a couple of years ago by a friend of mine which she and I usually disagree about everything. That is Gigi Sohn the Executive Director of Public Knowledge. A couple of years ago she came back from the consumer electronics show and she in a

paper she was describing all the technologies and companies and deals she had seen. She characterized and said, "DRM tools protect some of the content and consumers can decide whether that protection is flexible enough for their needs." "And the marketplace for delivering content digitally over new technologies is working." I think that is probably generally right, it is working. The problems we are talking about are probably pretty small, very small as a percentage of the whole market. And then Gigi said something which I really loved. In this paper further on in fact the next line she said, "all of these great developments happened without government intervention." I love that. I have certainly been pummeled enough for the DMCA being government intervention. Apparently now, a decade later, it does not seem like much intervention at all. I think there's a lesson to be taken from that. I do believe some of the remarks that Fritz and Steve said earlier that and Robert said it also that we might have found ourselves in a technological arm race between digital locks and digital lock picks without the DMCA. One lesson I want you to take from Gigi's remarks is that if your regulation is sufficiently light, it becomes part of the background environment and people actually don't worry about it as altering what they perceive as the marketplace. We pretty much live in a world now where instead of where we might have ended up without the DMCA, we might have ended up in a technological race between locks and lock picks. We might have ended up in a world where the devices to break technological protections measures were built into certain browsers or built into certain operating systems. We don't live in that world because of the DMCA. We have a substantive regulation which is forming

part of the background of the market we now have. What that substantive regulation did not do in the United States and did do in some countries, is there was no effort in that substantive regulation to attempt to determine the relationship between copyright law and contract law. That remains a huge fault line for our debates. Where as the United States and some countries that have followed us like Singapore have arranged a regulatory and administrative procedure that allows people in certain circumstances to circumvent a digital lock, that is in effect a regulatory authorities saying these sorts of locks are disfavored. We don't have the kind of system that Nicolas will talk about further that you will see in many European countries where the content owner is told to make some capacity or some ability available to the consumer despite the DRM. That is where there is a substantive allocation of the rights. So the United States have never been willing to go that far. If we went down the path of that debate, I think it would be very difficult and I think I would probably try to find a different area of the law to teach. Because I don't think it would come to an easy, successful conclusion. On the issues however of information regulation, I think we could do a lot more. I'm sorry how much time do I have left? Thirty seconds. That is good. I think we could do a lot more, but I think that here I agree 100 percent with Jason that we just don't know enough. I have to tell you something from working years in government and that is the agencies that regulate don't do empirical research. They are indeed -- they would be crappy at it. We really need to know a lot more and we need to recognize that when it comes to consumer expectations they vary tremendously from product to product and we should

assume that they will vary over time unless we lock down those expectations through regulation, which is a decision we could make. I am very, very wary of regulating the information structure except on a case-by-case basis. On the other hand I am a big advocate as some people may have heard me say before of using that kind of regulation as a Damoclean sword. I think it should be there and should be kept shiny. The FTC should be out wielding it in swordplay to keep the content owners not just receptive to consumer expectations and to functioning in the marketplace, but aware that consumer dissatisfaction can take the form of regulation. I think that is a very salutary effect that things like today's town hall and general constant oversight can do holding that Damoclean sword over the content owners.

>>CARL SETTLEMYER

Thank you Justin. I will use that Damocelan sword to cut off your time here. I will pass the baton down to Salil who will give his perspective on some of the issues.

>>SALIL MEHRA

Thanks for having me. I just want to say this is based on a paper I wrote a little while ago called digital fraud which is not to say that all DRM is fraud which is an unfriendly and unfortunately not uncommon word now. I just want to refer briefly to the idea of fraud -- common law fraud. Basic, elementary legal idea. Liability attaches from making an intentional material misrepresentation to induce someone to act and they rely and

suffer. Most commonly by getting less than they paid for. This is not to say that all DRM is fraud but to say that something like fraud happens with the way in which DRM is implemented. I want to point out too that we don't have such good data or experience about consumer expectation as several people have pointed out. We do have 200 years of experience with this concept which I would say helps us to coordinate both our expectations and our behavior in the marketplace so that even if you don't know law, you do have a sense of the common law of the marketplace. Why not just call this what is going on with what I am talking about with DRM, why not just call it fraud. Why call it digital fraud? There are differences both in what is going on and how we should approach it because I think DRM might have real positive benefits. Again we don't know. Empirical question we need data on. The first is I don't think we usually see affirmative misrepresentations about DRM. At least I hope we don't see that too often. Rather we see something a kin to concealment. People are purchasing things that appear whole. But turn out to be limited. Appears is the key question. Does it appear whole? I'll talk about that in a little bit. They may be experiencing and again data is unclear as it relates to expectations. Some kind of unfair surprise that leads them to get less than they bargained for. The classic harm of common law fraud. Part of this we could address this in part by thinking about the economics of advertising. Think about if you know what an experienced good is a good that you don't realize if it was really what you wanted and whether it was worthwhile until after you experience it. Classically there are information costs at the time of purchase to understanding whether this is a

beneficial good for you, but you will usually learn over time assuming there is not major information asymmetries. So you have information costs in this time lag. It could be very simple and something like fruit. You don't know if the apple or banana will taste good. There are clues. You could smell it and you will know soon enough and it is de minimus. But it gets more complicated. Often we have this claim to try and tell people it will be good and a disclaimer. An ad I saw recently that will get your attention for a home pregnancy test. The spoke person said wouldn't it be great to know if you are pregnant at the moment it happens. And then immediately the spoke person said, of course, this is not be possible. With digital products and technology we have claims and disclaimers that are nowhere near that clear. People buy these products and digital content and they don't understand as people have referred to already because of the long EULAs. We have something that is like the spirit of fraud. Here is a minimalistic PowerPoint here's a Dilbert cartoon. The boss is introducing Dilbert to the director of markettexture who is in charge of preventing consumers from realizing what they're buying. As the boss says it's legal because were only violating the intent of the law. Then the guy goes on to say something vaguely false, but unverifiable. You can do a thousand push-ups when no one is looking. The question is is this funny because it is true? If you will say wait a minute, consumers dealing with these problems and understanding the gap between claim and disclaimer, between what they appear to be getting and the limited thing they are getting, you might say, do we need regulations? Is this a market failure? Couldn't they just inform themselves? There are several

problems. The first is something I would call stealth DRM. It is hidden and buried in the product. You have to break it open to find it or it is something that while it exists is not currently implemented. So that you don't have good reason to know it exists. It could be implemented in the future. Second problem is rational ignorance. We live in a world of bonded rationality or we'd go crazy. If we rely on, for example, the compact disc logo that we have relied on for a quarter-century thinking if I buy this thing with the logo it will play in my player which has this logo. There is not a lot of good reason for us to inspect behind that and find out that the DRM on this disc will prevent it from working in this player perhaps. That is not something that is worth our time to investigate. There is also potentially a collective action problem on a broader ecological level is the idea of trust in the marketplace. It may not be worth it for us individually to take steps to figure out what is going on. As a marketplace and a group of consumers, we may tend not to trust what we buy and that will have negative affects overtime. Finally, there is the problem of the time lag itself. The after purchase exploitation. Whether that is for example, with HDMI where there is the possibility of debilitating or degrading the signal years from now. Whether it was implemented or not already exists in the technology or whether that is something as simple as the spiral frogs (ph) site that just shut down. People watching advertising to get music, but in 60 days they won't have the music even though they watched all the advertising because the authentication servers are shutting down. All of these ideas are ideas about market failure and are arguments for some sort of law or regulation. That does not mean that we should necessarily step in and have

broad-based litigation about this. I think some of Justin's concerns are very right about locking in expectations of the marketplace right now. Common law class actions for example would do that. But it might be worth considering and these are just proposals at a very early stage, whether some kind of administrative action is required. Whether that is simply a guideline or something along those lines whether it is nonpresidential actions in an ad hoc fashion. To try to again coordinate behavior and expectations in the manner that for example common law fraud did in the marketplace for a hundred plus years. We may want to consider as people have mentioned already special remedies legitimating circumvention. Obviously that imply something about our treaty obligations and our existing law where we think this kind of conduct, digital fraud, where we think this has occurred. Finally, I would also say that we should think about making any remedy we take somewhat business friendly in the sense that we should consider Safe Harbors in particular to the extent that we are talking about is an information costs or hidden DRM and things like this. It may be worth creating Safe Harbors for those enterprises that take steps to reduce or minimize -- good faith steps to minimize these problems and perhaps creating a race to the top instead of a race to the bottom. Encouraging innovation in that respect in how disclosure is made. In general if there was principle that I would like to stick to, its the idea that we should avoid stealth DRM. The last point, just to thank Scott Adams who gave consent for the cartoon.

>>CARL SETTLEMYER

Now onto Nicolas Jondet.

>>NICOLAS JONDET

Hello. I first would like to thank the FTC for inviting me to participate in this conference.

I will discuss research conducting with Professor Jane (inaudible) of the University of Washington. She is in France and I am here and so there is something that we have to better organized next time. I am happy to be here and concerning the weather, I live in Scotland so it is summer for me here. [laughing]

The meeting is about US law and I will discuss what is happening in French law and try to see whether what is happening in French law can inform the debate in the US and I will argue that what has happened in French law has already benefited US consumers especially in the field of online music. I explain how globalization does work both ways sometimes. What have been the issues raised by French consumers with regard to DRMs? One of the first one is prior region coding. That is an issue that people outside of the U. S. have to deal with because they want to have access to the latest -- when it is released on DVD and don't want to have to wait for many years for it to come to their country. Another issue is for video games. For instance, I can confess that a long time ago I had to go to a French video game store in Paris to have my PlayStation modified or fixed so that it could play video games from the U. S. Because the French version had been released a year later. People do go to quite some length to try to circumvent

this particular restriction. A problem with copy prevention there has been a lot of litigation in France relating to DRMs on music CDs. So you have to know that in France it was one of the first countries to introduce DRMs on music CDs and also was the country where they were the most widely used. There has been a lot of litigation on that. The lack of interoperability also been a problem in France. Lastly, the most important problem is regarding private copying. In France we have a private copying exception. There is expectation from the consumer that they are allowed to do private copies of DVDs for instance. This is heightened by the fact that in France when you buy blank media you pay a tax that is suppose to compensate the loss when you do a copy. There is a system in place so people and consumers are even more entitled to assume that they are allowed to make a copy. So it is important to realize that in the US, the DMCA was passed in 1998. In France we did not have any law acknowledging the existence or protecting the -- until 2006. In between the courts had to apply a mix of international and consumer law and existing copyright principles to address the issues posed by DRMs. The first question was to whether DRMs were legal. Consumer groups said there is no way in the French code where there is legal recognition of DRMs. For us it does not exist. The court said it is not in the code, but it is an international agreements so the whiteboard treaties and the copyright directives. They are legal even though they are not in the code. So the courts also had to apply consumer principles. For instance in 2005, the court of appeals in Versailles found that a DRM protected CD sold by EMI was faulty because it could not be played in a car CD player so EMI, a British label had to

pay damages for that. In 2007, a Paris court found that Warner Music had actually satisfied its obligation of disclosure because Warner made it clear to the consumers that they could not play this DRM protected CD on all CD players. Warner Music was fine with that. And however in 2007, another case the Supreme Court said that EMI was found guilty of deceptive practices because they had not disclosed that the CDs sold were not compatible with all CD players. Basically what EMI had done was to say that -- was to not label the CD as audio CDs. If you use this label on a French logo this is a sanction logo and a sanction label which implies that you can play the CD on every CD player. The French said you cannot use this logo. It is deceptive practices if you do that. These CDs cannot be played everywhere. EMI had to pay a fine and also damages to consumer groups. Lastly, Sony was found guilty also of deceptive practices for its Sony Connect Service. Because Sony did not disclose the fact that you had to -- could only buy music on Sony's platform if you had a Sony Walkman. At this time the practices were found in breach of French copyright law. So I have to go fast. Let's fast-forward to 2006, the French copyright law, French lawmakers had to [inaudible] and give legal recognition to DRMs which they did. They were happy to do it. At the same time, they wanted to balance that with more Consumer Protection. What they did for instance is that they introduced a statutory obligation to disclose the presence of DRMs and the implication on copyright exceptions especially the private copying exception. We don't have details on what the right holders need to do, but the principle in the law is that in France in copyright law and not just in consumer law. More importantly, there

have been attempts to regulate DRM so for instance now it is a legal requirement that DRMs cannot prevent the benefit of copyright exceptions. Also there is a legal requirement of interoperability between DRMs. And lastly, the French created a copyright authority that is in charge of enforcing those two requirements, ensuring that consumers can benefit from copyright exceptions. And also ensuring that there is interoperability within DRMs. So far there has not been any case, any cases, any case, but I would argue that it has had an impact in the fact that Apple was passed and said that it was a state-sponsored price, that was the comment of Apple. The US Commerce Secretary said they would investigate the law because before it was in breach of the obligations. However, a few months later, Steve Jobs had his epiphany and said now we want to change our policy and promote DRM free music. I believe that the French law was one, just one of the factors that may have helped Steve Jobs change his mind.

>>CARL SETTLEMYER

Thank you, Nicolas. Our time is up. Unfortunately I don't have time to ask questions that have been sent into the audience. I don't even have time to ask my own questions.

Thank you to are panelists who have traveled -- Oh, we have ten minutes. I was thinking that -- well never mind. In that case, I will maybe ask one or two questions. The main question I want to ask is goes to Justin's distinction which I think is a very good one between substantive issues which in some ways inform what needs to be disclosed in the information provided and the information issues and that is the type of terms that

come into play in the advertising for goods and the digital goods and services. The type of disclosures that are made in terms of additions and I will direct this to Steve and we can go down the line. When consumers are told in advertising before a transaction they can own or buy a digital download whether or not it is protected by DRM, does this kind of representation conflict with any language and terms and conditions documents that basically gives the import that the consumer is merely licensing the content?

>>STEVEN J. METALITZ

Thank you. When people are trying to figure out the alphabets soup in Washington, I sometimes tell them that the FCC is concerned with four letter words, but the FTC is concerned with three letter words like own and buy. In this area I think that distinction holds true. From a copyright perspective let me just tell you that the significance to this question of whether the transaction is a sale or a license has to do with the for-sale doctrine which you talked about. Several people talked about. In very simple terms, if it is a sale, the buyer is free to dispose of the copy. The Jeff Bezos example with the book. If it is a license, then the licensee may or may not be able to do that depending on the terms of the license. I think this is a significant particularly in the hard goods area, but in the online area, I think we have to recognize that there's something else at work here. The for-sale doctrine applies to the copy that you have acquired. Does not apply to a copy of that copy. Because it is something you obtain online, you generally have to make a copy in or to transfer the copy, the for-sale doctrine does not apply in the same

way. It is one thing if you are giving away your hard drive which has work on it that you have obtained a copy on through a sale. It is different if you are trying to give a copy to a friend and you end up still keeping the copy that you have. That is not covered by the for-sale doctrine. What does this all have to do with DRM although I noticed your question excluded DRM? DRM may help provide a solution to this problem because if you think about the kinds of things that DRM can do, it can include enabling somebody at least in theory, it can enable somebody to transfer the copy -- make the copy, transfer that to somebody else and then no longer have access to their own copy or the copy that they originally got. That would be the true analogy to the used book situation. After I buy the book and give it to someone else, I no longer have it. DRM may help to solve this problem, rather than presenting a problem in this environment.

>>CORYNNE McSHERRY

The first thing I'd say is that actually DRM could help, but I don't think you need DRM to answer this problem. All you need is a consumer. If you want to transfer an individual copy just have the consumer delete the original copy and transfer it. You don't need DRM to make that happen. People can do that all by themselves. The second thing is getting back to your original question, I think this distinction is important. Over the past year there have been a battle in the courts over when does a license look like a license and when does it look like a sale. That has been quite an important question because of the for-sale doctrine and what it empowers people to do on the other end. If you call it a

license, but it looks like a sale, if it looks like a duck, quacks like a duck, maybe it's a duck even though you called the licensor a goose. Whatever. I will leave the analogy alone. The distinction is very important and I do think that we have to concede that it is deceptive if you put out a lot of advertising that suggests that something you are owning or buying. People have decades of expectations based on that language. If you surreptitiously say it's a license, but folks don't realize that, I think that's a fundamental contradiction and a fundamental thwarting of consumer's expectations.

>>JUSTIN HUGHES

I am troubled by that and I agree with Corynne that there is a fundamental problem there. I admire her as an advocate to have actually said with a straight face, you just have the consumer delete the original copy. I have been out of the courtroom too long, I could not do that and blush. Obviously DRM is necessary to make a digital for-sale doctrine work so I agree with Steve although that is not directing your question. But I am troubled with this own or buy. One of the -- the real point I want to make is do not assume that the physical world analogies of consumer expectations always translate to the online and downloaded network world. They may not. Maybe we should not be using words like own or buy. On the other hand we needn't assume that the average consumer thinks they will be able to do everything they can do with a CD that -- or with a digital download that they can do with a CD. I don't think that. I don't think my nephews think. They are 21 and 16.

>>CARL SETTLEMYER

Just to through in a comment here. Isn't there a potential -- particularly in the online download context, isn't there a potentially huge information asymmetry between the seller of the good who is in position perfectly well explained to the consumer to say what is going to happen and try and come up with an effective way to communicate that versus the person who is buying that may not know anything. Isn't it incumbent on the seller to set and manage those expectations not sort of at large but sort of in particular transactions to understand that?

>>MALE SPEAKER

Let me question that for a moment. In general what you say is true. When you think about Jason's typology of the different things that DRM can do. If you think about several of those such as use issues and the longevity and the ones in the first room. I'm not talking about security and privacy questions. Why is it necessarily important that the consumer know all about that if in fact the use that he is making, the enjoyment that he is able to derive from the video game or the movie or whatever the product is, if he is use does not but up against these limits. If he is not trying to use it on six different machines but only five or if in other ways he is not coming up against these limitations, that may be the best outcome in the marketplace which is that DRM is transparent. People are not even focused on it. They are focused on the value of what they are

trying to acquire. To put some of the economic analysis into context, I think that when people acquire or gain access to a movie or a video game or a PC game or music, their main concern is do they enjoy the movie, is the game good to play? Did they find it absorbing and interesting? These other issues could be significant to some consumers in some circumstances, but it is a positive when they are not significant to consumers and the fact that the DRM provides them with enough flexibility to get what they want out of the transaction which is a good movie, a good game etc.

>>MALE SPEAKER

I have a very quick comment which is I actually think there is the potential for greater asymmetry with DRM with technology between what the producer knows and the consumer. I think it is that a second degree which is there is a potential for asymmetry about how big the asymmetry can be. For a lot of things, is there termites or are there termites are not in your house? We know what the magnitude and the scope of the asymmetry might be. Other things like that. I think we now have an evolving technology where people may not actually understand what asymmetry can be and how big it can be in the future.

>>CARL SETTLEMYER

One corollary to that is is it appropriate for sellers to use buyer owned to advertise a transaction for content that is protected by DRM and use is dependent on the future

availability of authentication servers that may not be there the following year?

>>MALE SPEAKER

I think if you look at how that has played out in the marketplace, there have been instances of this. One of the following things or some combination has happened. Either the authentication server has been continued in operation. Either some other method has been given to consumers to burn copies or otherwise obtain permanent copies or there has been some type of monetary compensation or some combination of those. One thing we have to be aware of in that circumstance is are we saying that if someone chooses to experiment with a particular business model in this environment that in effect they are signing up to a life sentence. They are not able to exit that market without extremely high cost of meeting some unfunded liabilities perhaps if you want to look at it in those terms. [overlapping speakers]

>>CARL SETTLEMYER

On whose shoulders should that risk be placed? The seller who knows their cash flow and cost structure and so forth versus the consumer who may just only see some [overlapping speakers]

>>MALE SPEAKER

That is a fair question and that is why you have seen it work out the way it has in all of

these instances in the marketplace whether you want to establish that as a rigid rule is really sort of a question of which -- to what degree you want to encourage experimentation in the market place including by entities that don't have such deep pockets. Remember we are talking here about access to music and other things where in many cases there are other sources available and people can make a choice in that regard.

>>MALE SPEAKER

People have to pay again.

>>MALE SPEAKER

Maybe they don't. There is also -- there has been advertising support in streaming services. There are streaming services now which DRM makes possible which really lower the cost to everybody because you are not paying for the full -- this whole spectrum that the consumer can choose from.

>>CORYNNE McSHERRY

In response to your first question, I think the answer is clear. No. Easy answer there. You want to give that to the judge when you can.

>>CARL SETTLEMYER

Whether or not it is appropriate to use terms like buyer owned for an authentication server contingent type service?

>>CORYNNE McSHERRY

I want to say the answer to that is no. And I think that we saw that there was a huge uproar and response to that because consumers also felt that the answer was no and to the extent that those companies realized that they had a problem, they only did that because there was an uproar and a response and if there hadn't been -- which showed you that their consumers felt their expectations were violated. Then that is what made the companies realize that we need to do better. And to Fritz's question -- I'm sorry Steve's question of whether people should be able to experiment with business models and then abandon them if they are too expensive and leave consumers with the price, I realize that's not exactly the way you put it, but that's the way I would put it. I think the answer to that is of course you can't do that. Of course consumers should not have to pay the price for folks experimentation. Great experiment. But you make a commitment to consumers when you do that and you have to uphold that commitment.

>>MALE SPEAKER

I think we have to close but Nicolas do you want to wrap up?

>>NICOLAS JONDET

On that just to say that usually the experiment happens in the US and in Europe we just wait one or two years and have the big guys who eventually won in the US come and import the finished products to first the UK and then the rest of Europe. There is less innovation.

>>MALE SPEAKER

Is that sour grapes Nicolas?

>>CARL SETTLEMYER

I think we really are out of time this time. Thank you all for coming. Sorry we did not get to the audience questions. Hopefully the debate has been enlightening and you may have gotten some of your concerns out there. Thank you very much and we will reconvene in about 12 minutes at quarter to 11. Thank you. [applause]