# DEBUNKING THE "STIFLING INNOVATION" MYTH: THE MUSIC BUSINESS'S SUCCESSFUL TRANSITION TO DIGITAL

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In his article "Copyright and Innovation: The Untold Story,"[1] Professor Michael Carrier reflects a common misunderstanding of the role of copyright in society, the relationship between technology and copyright, and the role of record companies as innovators. He also ignores evidence of how new consumer offerings during the last decade have flourished compared to the static options available to music consumers during the half century before that time. The years since the *A&M Records, Inc. v. Napster, Inc.*[2] decision tell a story of vigorous licensing of new models by large and small record labels, large investments in music services and related technology, and a vibrant digital market that dwarfs the growth in other media industries. The purpose of this Reply is briefly to elucidate these points.[3]

## COPYRIGHT, THE CONSTITUTION, AND THE ROLE OF RECORD COMPANIES

Professor Carrier tends to juxtapose copyright against innovation, failing to recognize that the Founders granted Congress the authority to protect creative works precisely to promote innovation.[4] Indeed, as the authors of a recent article described, the Founders recognized that copyright protection is grounded in pre-existing rights meant to protect economic incentives and the inherent right to the fruits of one's labor.[5]

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1. Michael A. Carrier, *Copyright and Innovation: The Untold Story*, 2012 WIS. L. REV. 891.

2. 114 F. Supp. 2d 896 (N.D. Cal. 2000).

3. This Reply does not attempt to respond to the myriad anonymous assertions set forth in Professor Carrier's article. As Professor Carrier admits, the anonymous statements he cobbles together are speculative. *See, e.g.*, Carrier, *supra* note 1, at 895. These anonymous indictments are provided without context and facts or data to support the conclusory theories offered in the article.

4. U.S. CONST. art. I, § 8.

5. Paul Clement, et al., *The Constitutional and Historical Foundations of Copyright Protection*, CENTER FOR INDIVIDUAL FREEDOM (Dec. 12, 2012),

Although Professor Carrier rightly recognizes the importance of innovation,[6] he assumes that the only type of innovation is technology and fails to include copyrighted works as part of the innovation that fuels economic growth. Numerous studies have demonstrated the value of copyright industries to this economy.[7] Simply put, copyright and innovation are not mutually exclusive.

Record companies have invested billions of dollars to create the recordings that provide a soundtrack for the lives of most people.[8] Much like venture capitalists, record companies invest money under extremely risky circumstances. Approximately nine out of ten investments in new recordings are failures.[9]

But record companies are more than investors that make innovation possible. Record companies frequently are a critical part of the creative process that results in the innovation. Record company employees scout hundreds of thousands of artists, help develop repertoire for recordings, and actively participate in the recording process.[10]

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http://cfif.org/v/index.php/commentary/42-constitution-and-legal/1679-the-constitutional-and-historical-foundations-of-copyright-protection.

6. *See, e.g.*, Carrier, *supra* note 1, at 893, 959.

7. *See, e.g.*, COPYRIGHT INDUSTRIES IN THE U.S. ECONOMY: THE 2011 REPORT, INT'L INTELL. PROP. ALLIANCE (2011), *available at* http://www.iipa.com/copyright_us_economy.html.

8. *See* Testimony of Linda McLaughlin, Docket No. 2006-3, CRB DPRA, Nov. 30, 2006, *available at* http://www.loc.gov/crb/proceedings/2006-3/riaa-mclaughlin-amended.pdf. Moreover, as a one-of-a-kind study demonstrated, the terms of initial agreements that prove successful are almost always renegotiated, eroding the benefit of the bargain for the record company. *See* Steven S. Wildman, An Economic Analysis of Recording Contracts 25–28 (July 22, 2002) (unpublished manuscript) (on file with author). How many other venture capitalists live a reality where successful investments are diluted by after-the-fact renegotiations? *See id.*; Testimony of Steven M. Marks before California State Senate Joint Senate Judiciary / Select Committee on the Entertainment Industry Hearing on Accounting Practices in the Recording Industry, July 23, 2002, at 3–4 (on file with author); Rebuttal Testimony of Steven S. Wildman, Docket No. 2006-3 CRB DPRA, Apr. 3, 2008, at 4–5, *available at* http://www.loc.gov/crb/proceedings/2006-3/wildman-wrt.pdf.

9. *See* Testimony of Steven S. Wildman, *supra* note 8, at 10–12; Chuck Philips, *Record Label Chorus: High Risk, Low Margin*, L.A. TIMES, May 31, 2001, http://articles.latimes.com/2001/may/31/news/mn-4713.

10. Testimony of Michael Kushner, Senior Vice President, Business and Legal Affairs, The Atlantic Recording Group, Docket No. 2006-3 CRB DPRA, Nov. 29, 2006, at 4–7, *available at* http://www.loc.gov/crb/proceedings/2006-3/riaa-kushner-amended.pdf; Testimony of Dennis Kooker, Executive Vice President, Operations and General Manager, Global Digital Business and U.S. Sales for Sony Music Entertainment, Docket No. 2009-1 CRB Webcasting III, Apr. 7, 2010, at 3–5, *available at* http://www.loc.gov/crb/proceedings/2009-1/pffcol/soundexchange_exhibits.pdf.

## THE MUSIC INDUSTRY, TECHNOLOGY AND INNOVATION: A SUCCESS STORY

Professor Carrier also mischaracterizes the relationship between technology and copyright. Professor Carrier inappropriately pits copyright against innovation as though the two are boxers sparring for control rather than partners that work collaboratively and interdependently. The desire of consumers to listen to music has been a driving force for technology and recording companies to build and invest in new platforms and configurations, from vinyl record players to cassette players to CD players to iPods.

We have seen more evidence of this interdependence in recent years than ever before. Let's rewind to the 1990s, a time when consumer options to listen to music were limited to two choices—tuning into a terrestrial radio broadcast, or purchasing a CD or cassette. Fast forward to today and consumer choices have blossomed to include a wide variety of products and services: DRM-free downloads, all-you-can-eat subscription services, free on-demand audio and video services, music bundled with a phone, cloud and locker services, and specialized digital radio outlets to name a few.

Today, more than 500 services offering these consumer options exist, tenfold the number merely ten years ago.[11] In the United States, revenues from digital services exceeded $4 billion in 2012 compared to less than $200 million nine years ago.[12] The music industry now derives almost sixty percent of its revenues from digital services and is far ahead of other media industries when comparing the transition to digital services.[13] These statistics belie Professor Carrier's theory that the music industry has seen little innovation since the *Napster* decision.

Professor Carrier also states that "[v]enture capital funding in the area of digital music fell significantly after the *Napster* decision."[14] This rhetoric is fashionable among detractors of copyright enforcement. When the United States Supreme Court was deciding the *MGM Studios, Inc. v.*

11. INT'L FED'N OF PHONOGRAPHIC INDUS., IFPI DIGITAL MUSIC REPORT 2013, at 6 (2013), *available at* http://ifpi.com/content/library/DMR2013.pdf.

12. *RIAA Shipments Database*, RECORDING INDUS. ASS'N OF AM., http://www.riaa.com/chartindex.php (last visited May 13, 2013).

13. *News and Notes on 2012 RIAA Music Industry Shipment and Revenue Statistics*, RECORDING INDUS. ASS'N OF AM., *available at* http://www.riaa.com/keystatistics.php?content_selector=2008-2009-U.S-Shipment-Numbers (last visited Apr. 29, 2013) (follow "2011-2012 U.S. Year-End Industry Shipment and Revenue Statistics" hyperlink).

14. Carrier, *supra* note 1, at 916.

*Grokster, Inc.*[15] case in 2005, a group of venture capitalists warned that a ruling against Grokster would dry up venture capital investment.[16] Yet after the Supreme Court's unanimous ruling against Grokster, venture capital investment grew in the media and entertainment sector by more than fifty percent.[17] Venture capitalists invested more than $1 billion in music companies in 2011 and 2012 alone.[18] This reality is the best response to Professor Carrier's assertions that aggressive enforcement against Napster and its progeny has left technology companies, record labels, venture capitalists, and consumers in a worse position than if Napster won the litigation.

But logic also dictates a conclusion contrary to Professor Carrier's conclusion. It is hard to imagine why Napster, after fighting to avoid the need to obtain licenses, would have voluntarily negotiated licenses and paid royalties if it won the case. A finding for Napster would have instantly granted online services the right to copy and distribute music without any permission or license. Likewise, after *Napster*, some companies tried to architect services around the court's decision.[19]

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15. 545 U.S. 913 (2005).

16. "[A ruling against Grokster] would have a *devastating impact* on the development of legitimate and valuable new products and services for consumers." Brief of the National Venture Capital Association as Amicus Curiae for Respondents at 6, *Grokster*, 535 U.S. 913 (No. 04-480), 2005 WL 497759 at *6 (emphasis added).

17. Investment grew from 4.6% of total VC dollars before *Grokster* to 7.1% afterward. *See Protect IP's Groundhog Day*, MUSIC NOTES BLOG (Jul. 21, 2011), http://www.riaa.com/blog.php?content_selector=riaa-news-blog (follow "2011" menu button; then follow "JUL" button; and then scroll down to the blog post); *see also 1995-Q1 2013 Historical Trend Data Spreadsheet for the U.S.*, MONEY TREE REPORT, *available at* https://www.pwcmoneytree.com/MTPublic/ns/index.jsp (last visited Apr. 21, 2013) (showing that aggregate VC financing in the media and entertainment industries from $1,409,032,600 in 2004 to $1,966,158,500 in 2012).

18. Paul Resnikoff, *Music Investment Tops $600 Million in 2012; Up 34%..*, DIGITAL MUSIC NEWS (Dec. 17, 2012), http://www.digitalmusicnews.com/permalink/2012/121217investment.

19. Indeed, many of the founders and operators of file sharing services depicted by Professor Carrier as "innovators" were found by courts to have encouraged the illegal trading of other people's creative works. Professor Carrier omits the fact that federal courts agreed with the record companies, delivering stinging rebukes of the massive copyright infringement that these services contributed to or induced. The Supreme Court stated: "Grokster and StreamCast's efforts to supply services to former Napster users, deprived of a mechanism to copy and distribute what were overwhelmingly infringing files, indicate a principal, if not exclusive, intent on the part of each to bring about infringement." *Grokster*, 535 U.S. at 939. Judge Posner in the *Aimster* case, noted that, "far from doing anything to discourage repeat infringers of the plaintiffs' copyrights, Aimster invited them to do so, showed them how they could do so with ease." *In re Aimster Copyright Litig.*, 334 F.3d 643, 655 (7th Cir. 2003). The district court judge in *Arista Records* found that LimeWire purposefully marketed its service to individuals who

Professor Carrier refers to these as innovators, yet none of these new services and technology meant any money for creators.

Thus, one might conclude the opposite of Professor Carrier's thesis: the *Napster* case and the strategic enforcement that accompanied vigorous licensing by record companies enabled rather than dried up investment in music.

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were known to use file-sharing programs to share copyrighted recordings, optimized LimeWire's features to ensure that users could download infringing digital recordings, and assisted users in committing infringement. *Arista Records, LLC v. Lime Group, LLC*, 784 F. Supp. 2d 398, 427–29 (S.D.N.Y. 2011).