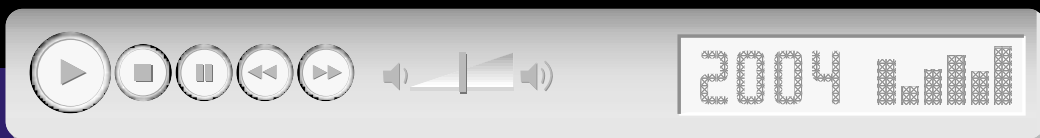


IFPI online music report



representing the
recording industry
worldwide

The Music Industry's Internet Strategy Is Turning The Corner



For everyone working towards the creation of a successful legitimate online music business, the start of 2004 brings a new sense of optimism along with evidence of real change.

Legal online services are spreading quickly across the United States, and are now beginning to take hold firmly in the rest of the world. A picture of healthy competition is emerging in Europe as legitimate services such as iTunes, Napster and Rhapsody, as well as scores of retailers, Internet Service Providers (ISPs) and hundreds of record companies, vie to break into a new online market in the first half of 2004.

Availability of legally licensed music online from a multitude of websites in Europe is increasing sharply-growing during the last three months of 2003 alone, from a total catalogue of 220,000 tracks to nearly 300,000 across the various legitimate services.

Public awareness of the legal issues around online music distribution, a crucial part of our industry's online strategy, is much higher internationally than it was a year ago. Nearly 70% of surveyed respondents in four major European markets are aware that unauthorised file-swapping is illegal.

Robust anti-piracy enforcement - including lawsuits against large-scale file-swappers is increasingly accepted as the right and the obligation of record companies and other copyright holders. Market evidence appears to show that this strategy is working, with the total number of simultaneous illegal music files available on peer-to-peer services falling from an estimated one billion in April 2003 to 800 million in January 2004.

We believe that the music industry's internet strategy is now turning the corner, and that in 2004 there will be, for the first time, a substantial migration of consumers from unauthorised free services to the legitimate alternatives that our industry is providing internationally.

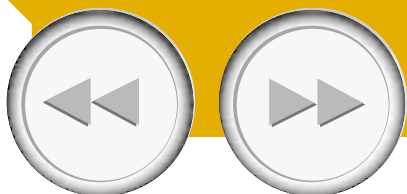
The purpose of this first such publication produced by IFPI is to raise awareness of the developments in the online music market, and in doing so, help accelerate them. This report focuses on the events that took place in 2003 as well as the prospects for 2004 - but it must not be forgotten that these are only the culmination of the work that the music industry and its partners have been doing since the mid-1990s to prepare a thriving legitimate online music business.

A handwritten signature in blue ink, appearing to read 'Jay Berman'. The signature is stylized and fluid, with a long horizontal line extending to the right.

Jay Berman, Chairman & CEO, IFPI

The report highlights:

- > The rapid development during the course of 2003 of a critical mass of legitimate online services, reaching around half a million consumers in Europe by the end of 2003 - a figure that is set to increase sharply in 2004. Yet the results of our survey, released for the first time in this report, indicate a very low level of awareness of the existence of these legitimate services among consumers.
- > A high level of awareness among consumers internationally that distributing copyrighted music on the internet without permission is illegal. Our survey shows that in a selected number of countries in Europe, 66% of all people were aware of this.
- > The impact of the industry's internet anti-piracy awareness strategies. Two factors explain the progress made in this area: the public information campaigns conducted around the world in 2003 and lawsuits against individual large-scale uploaders.
- > The increasing public acceptance of the industry's use of litigation as an important option of last resort to fight online piracy. Our survey figures show that 54% of respondents support the strategy of legal action, with 19% yet to make up their minds.
- > The industry will use litigation internationally where necessary, as it has done in the US. Making copyrighted music available on the internet without permission is illegal in virtually every country of the world. This is not a grey area and people who are breaking the law may have to face the consequences.
- > The different processes our industry is developing in order to create business models for the online environment. These are often underestimated and misunderstood outside the music industry.
- > Evidence that illegal file-swapping hurts sales of music. A survey of five major markets shows that 27% of people downloading illegally distributed music bought less music as a result.



The Growth Of Legitimate Online Music Services

A promising online music business emerges in 2003

2003 was the break-through year for online music services, as record companies expanded their licensing agreements across a wide variety of online retailers, offered consumers greater flexibility of track usage, began licensing the catalogue of major international acts and shortened the gap between off-line and online releases. During 2004 we are likely to see a sharp acceleration in the provision of online legitimate music for consumers to enjoy.

Major and independent record companies have now licensed hundreds of thousands of tracks for legitimate download in Europe. As an example of this, EMI in April 2003 announced the biggest European download initiative, making available over 140,000 tracks from over 3,000 EMI artists for sale online.

The music to mobile market has also benefited from an increase in licensing deals. This market continues to take shape as record companies embrace the ring tones market as well as downloads to mobile.

These recent developments build on a process that goes back to 1998, when eMusic.com began selling MP3 singles and albums on the web in the US. Steamwaves, another American service, launched in 1999 and was one of the first to offer a streaming subscription service. By the summer of 2001 OD2, the company founded by Peter Gabriel, launched its WebAudioNet platform, enabling retailers to offer legitimate services in Europe.

Many services followed from there. MusicNet, Pressplay and Rhapsody were launched in the end of 2001 in the US and were licensed by all five majors by the end of 2002. These are only some of the services that pioneered the legitimate online music market, many of which are still active in its development today.

Where are we now?

Legitimate services in the US

The total market for music downloads in the US during the second half of 2003 stood at 19.2 million as measured by Nielsen SoundScan (tracking download sales since July). Downloads outsold physical singles by three to one over that period.

According to an internet tracking research by Ipsos-Insight¹, the number of Americans who have paid for downloads doubled from 8% to 16% over the first half of 2003. The total catalogue of different songs available to US consumers across the various services was between 400,000 and 500,000 tracks - the equivalent of around 40,000 albums - by the end of the year.

Record companies license iTunes

It was in 2003 that legitimate online services really took-off in the US. This was driven initially by the success of Apple's iTunes Music Store, which was launched to Macintosh users (around 3% of computer users in the US) in April. According to Apple, iTunes sold an average of 500,000 downloads per week over the first six months, reaching a total of 13 million by mid-October when the service was rolled out to PC users. Apple reported sales of 1.5 million downloads in the PC market in the first week, helping to drive total sales to 25 million² by mid-December 2003.

iTunes' success lies in its simplicity, the wide and flexible usage rights of the tracks and its smooth integration with a portable digital player device - the iconic iPod. The service has been heavily marketed by Apple and, alongside Napster, has become a widely recognised brand name in online music.

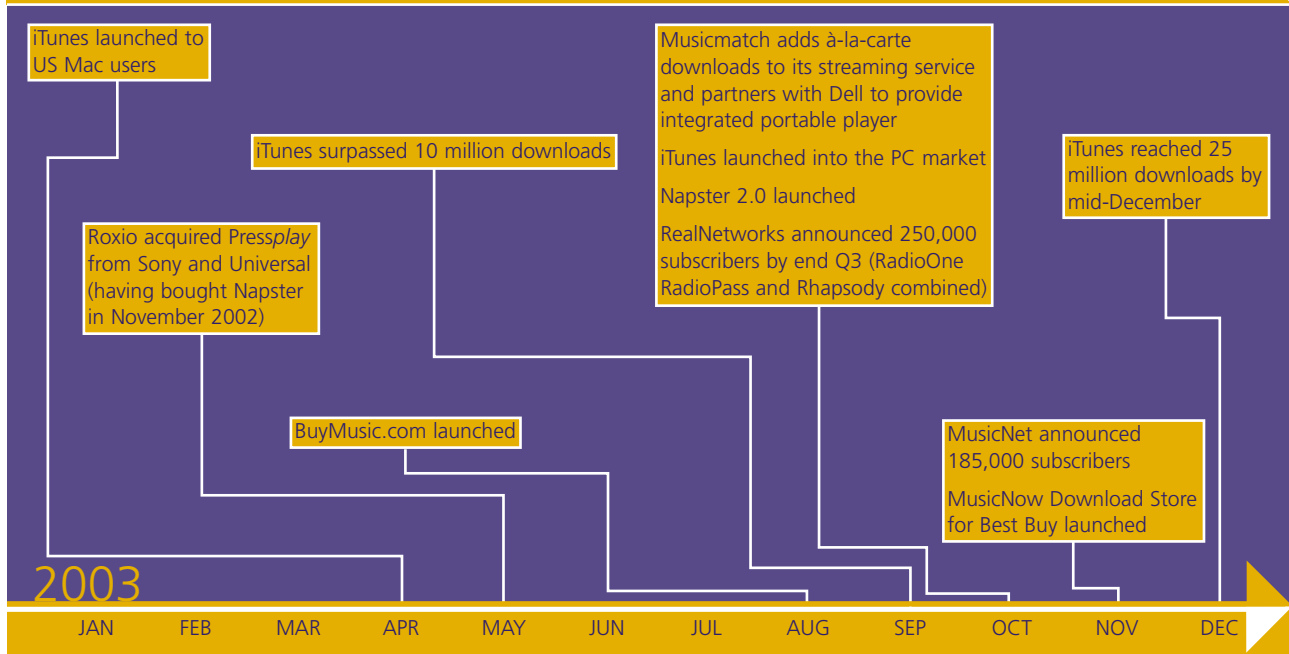
Since the second half of 2003, there has been a flurry of new service launches and existing service enhancements in the US. Most recently, in January 2004 retailer chain Wal-Mart started testing a digital service, Real Networks launched its RealPlayer Music Store offering over 300,000 tracks and Sony announced the launch of its Connect downloads service for April 2004, featuring 500,000 tracks.

Additionally Loudeye Corp. is developing 'white label' download stores designed for third parties to build branded digital music services. There have been further announcements by broadband providers, such as EarthLink, of partnerships with online music services to offer packages to subscribers.

1. Ipsos-Insight - TEMPO: Keeping Pace with Digital Music Behaviour, November 2003. Base: downloaders.

2. iTunes sales from April to mid-December.

Milestones in the development of the US online music market in 2003



The legitimate online music market has become very competitive, with services looking to secure new marketing routes via partnership deals with:

- **Broadband suppliers:** iTunes and AOL, Rhapsody and Comcast
- **Hardware manufacturers:** Musicmatch and Dell, Napster and Samsung
- **Other established brands:** iTunes and Pepsi, RealPlayer Music Store and RollingStone.com
- **Academic institutions:** Napster and Penn State University

Moreover, in January 2004 Apple announced its agreement to license the technology behind its digital music player, the iPod, to Hewlett-Packard who will bundle the iTunes Music Store software into its PCs. Hewlett-Packard also intends to release its own digital music player to compete with other products already in the market such as the Zen Xtra, Dell DJ, Rio's Karma and Samsung's Napster player. According to Apple, the iPod has sold over 730,000 units in the three months to December 2003.

Legitimate online music services in Europe - poised for sharp growth

A burgeoning online music market has already taken shape in Europe in 2003 through nearly 30 legitimate services. The launches of Entertainment UK (EUK) and Virgin Megastore France at the end of

2003 were the most recent in Europe. Most of the European services are OD2's brand partners, but several independent services are also beginning to emerge, such as Germany's T-Online 'musicload', launched in the summer of 2003.

Following the US example, European-based services have now widely introduced the à-la-carte option whereby consumers are able to buy single tracks. This sharply increased the number of customers for legitimate online services in Europe, which reached over half a million people across all services.

This figure is expected to rise further as services such as iTunes, Napster and Rhapsody enter the European market in 2004. The amount of available repertoire on the existing services has already risen sharply. Consumers can access between 275,000 to 300,000 tracks depending on the service used.

While customer numbers in Europe grow, awareness of legitimate services is still fairly low. A survey conducted by IFPI in December 2003³ found that only one in four people are aware of legal alternatives for downloading music. Although awareness of such services increases to nearly 40% for those aged 16-29, the industry clearly has some ground to gain in terms of making consumers aware of legitimate online services in 2004.

Other announcements include Coca-Cola's plans for its forthcoming service mycokemusic.com, due for UK launch in 2004, based on the OD2 platform.

3. Conducted by GfK Media for IFPI in Denmark, France, Germany and Italy (n = 3,500, random sample).

In Germany, Phonoline, a cross-industry business-to-business platform for online retailers and portals offering music services, is set to launch early in 2004 with many services able to offer 250,000 tracks at launch from all five majors and many independent labels.

OD2 has been instrumental in the development of the online music market in Europe, along with its retail partners including MSN Music Club, Virgin Downloads, Tiscali Music Club, HMV Digital Downloads, Fnac, TDC musik (Denmark), Karstadt and MTV DE. Aggregated data for European services provided by OD2 shows significant growth in the final three months of 2003.

Aggregated online indicators for Europe		
	End Q3 2003	End Q4 2003
Registered users	380,000	450,000
Tracks available (flexible use)	210,000	275,000
Tracks downloaded (monthly average)	220,000	300,000

Source: OD2

Most services using the OD2 'engine' offer a combination of streaming and à-la-carte downloads, with both subscription and pay as you go alternatives. Services differentiate themselves by a combination of exclusive content, flexible payment options and benefits for 'premium' service or broadband subscribers.

To further help the development of the legitimate online music market, IFPI and its record company members are working with music publishers and authors' collecting societies in Europe to create a simple framework for obtaining music publishing rights for legitimate online services. It is hoped that such an agreement can be reached early in 2004.

Summary of expected launches in 2004		
US Based	Europe Based	Elsewhere
Hewlett-Packard	iTunes (Europe)	Puretracks (French-version, Canada)
Microsoft	Napster 2.0 (Europe)	iTunes (Canada)
Amazon	Coca-Cola (UK)	MusicNet (Canada)
MTV Networks	PlayLouder (UK)	Napster 2.0 (Canada)
	Rhapsody (UK)	ninemsn (Australia)
	Phonoline (Germany)	iTunes (Japan)
	T-Online (Germany)	iBIZ (Taiwan)
	eMusic Kft (Hungary)	

Legitimate online services outside the US and Europe

The developments in the online space are mirrored outside the US and Europe. Canada's first legitimate online service, Puretracks, was launched in October 2003 with a catalogue of 175,000 tracks, including many local and international artists. The service offers single tracks and album downloads as well as exclusive material. By the end of 2003 the service's catalogue had reached around 300,000 tracks. A French-language version of the site will be available in 2004. The retailer Groupe Archambault also entered the Canadian online market in January 2004 with www.archambaultzik.ca, their French-language site which focuses on local Quebec talent.

In the Asia-Pacific region, the service provider Soundbuzz has access to a wide-ranging catalogue from international and regional labels, powering portals such as those of Hewlett-Packard Singapore and the India Times. Other operating services in the region are mylisten.com, PlanetMG, ilikepop.com and clickbox.co.kr. In Taiwan, the iBIZ platform imusic.com.tw, to be launched in 2004, will be that market's first legal music download service. The platform is set to offer 500,000 songs for download as broadband provision expands.

In Australia, Destra Corp. has created a digital music network, supporting services from Sanity and HMV among others. Destra has access to over 100,000 tracks and aims to reach 500,000 by mid-2004. Telstra Big Pond was the second to launch a download service, making available 200,000 tracks for download. Other services are expected to launch during 2004.

In Brazil, digital service provider iMusica, launched in March 2000, is the first online music service in Latin America. It provides 60,000 tracks from over 70 local labels and powers a wide variety of portals including MSN, Americanas.com and Compaq. The service allows for downloads, streams and on-demand CDs. During 2004 iMusica expects to broaden its existing catalogue and regional operations.

"We at the Orchard are very encouraged by the new legitimate download services. These new services are the backbone of our future business plans; they offer the perfect inventory solution and our product is always in stock. For an independent, that is a significant accomplishment."

Scott Cohen, Founder and President, The Orchard (largest distributor of non-major label music)

Building a legitimate download business: what the unauthorised services don't have to think about

Digitising content	Quality libraries of music repertoire need to be built from scratch. Hundreds of thousands of music tracks and supporting artwork need to be digitised to a high quality specification.
Rights-clearance and re-negotiations	Clearing sound recordings for online distribution can involve complex business considerations with a variety of parties. The sound recording rights need to be cleared with record companies and the rights in the songs separately licensed with relevant music publishers or collection societies. Rights in many recordings may need different licences in different territories.
High-performing technologies	Legitimate services are accountable to consumers and therefore need to ensure that download times are minimised for the range of consumers' connection speeds.
Consumer-friendly DRM and establishing 'usage rules'	'Digital rights management' systems are critical to legitimate services. Once a track is downloaded, consumers need to be able to store and use that track without violating copyrights. However there are complex business negotiations and DRM technologies behind such 'usage rules'. All these require clever and costly technological solutions.
Virus free services	Both content and operating systems need to be virus-free and reliable, requiring a range of supporting technologies.
Secure payment systems	Legitimate services must be paid for. Secure payment and billing systems need to be put in place, so that people can pay for music online using a variety of available means, from credit cards to pre-pay cards and special accounts.

“2003 was the year we proved that consumers would pay for digital music - it is absolutely clear there is a market. This has injected a huge confidence-booster to labels, to investors and everyone who is looking at it as a business to get into.”

Ed Averdieck, Sales and Marketing Director, OD2
(European online music distributor)

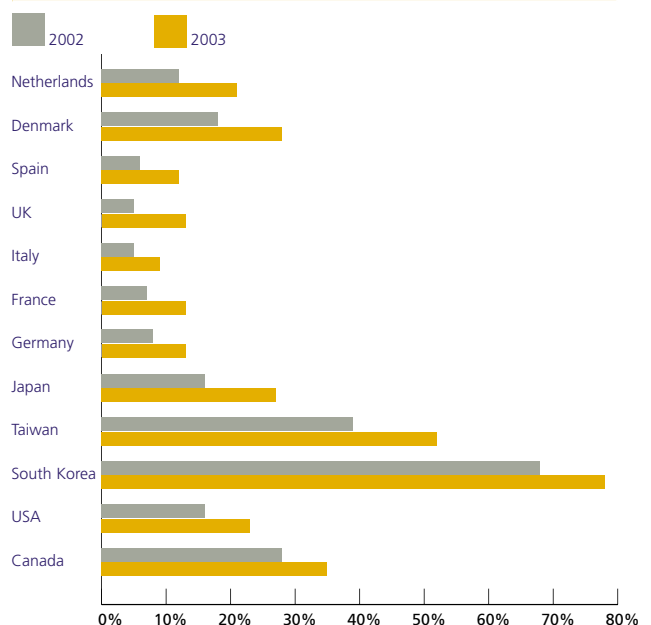
Building a legal online music market - a complex business

Record companies and many other parties have been working together for over five years to create viable online business models. However, this has proved an incomparably more complex undertaking than the setting-up of unauthorised distribution models - a fact that is often misunderstood outside the music industry (see table above).

Two further strategic issues have combined to slow down the development of the digital music market to date:

- Widespread piracy on the internet has provided unfair competition to legitimate services, thereby significantly increasing their business risk.
- The relatively low penetration of broadband internet services in many countries until late 2002/early 2003 markedly limited the growth of legitimate online music. This is changing as broadband penetration expands.

Household broadband penetration



Source: Understanding & Solutions

IFPI facilitates one-stop shop for Simulcasting & Webcasting

The industry is adapting its procedures in order to simplify substantially the licensing of internet music distribution, particularly streaming.

IFPI developed and announced two important one-stop licensing initiatives in 2003 to facilitate the roll out of legal streaming services. These initiatives - reciprocal agreements between record producers' collecting societies - enable the participating societies to grant blanket licences to music service providers clearing producers' rights and covering repertoire in all of the participating territories.

The Simulcasting Agreement covers record producers' rights to the simultaneous and unaltered transmission of free-off-the-air broadcasts via the internet. The Webcasting Agreement, announced in November 2003, covers services that stream sound recordings as part of programmed content, exclusively over the internet. The agreements do not cover the licensing of download services or individual on-demand streams.

The agreements are ground-breaking because, for the first time, streaming services can obtain licences that cover all the record producers' rights with respect to a multitude of territories (as of January 2004 the Simulcasting Agreement covered 36 countries) and a large proportion of the world repertoire from their local producers' collecting society.

Emerging business models still evolving

Business models offering both subscription and à-la-carte options with a range of single track downloads, album downloads, track streaming and customised streaming services, are thriving in the US and now growing in Europe (see chart below). There has been a clear trend so far from the predominant subscription model to the à-la-carte model - the simple format pioneered by iTunes.

Other innovative business models are also springing up, such as Wippit and PlayLouder Music Service Provider (MSP) in the UK. Wippit is the world's first subscription-based peer-to-peer (P2P) music service to secure needed licences, offering subscribers (approximately 5,000) access to music files for an annual fee.

Major services' business models

Service	Core Offer	Payment Method	Unique Offering
iTunes	à-la-carte downloads	pay per song, music allowance accounts, gift certificates sold at iTunes and Apple Stores	audiobooks, share music samples via email, exclusive tracks and on-demand videos, customised playlists, transfer to portable player (iPod)
Napster 2.0	track streaming, customised streaming, à-la-carte downloads	monthly subscription for Napster Premium, pay per song, Napster Card sold at over 14,000 retailers	playlist recommendations and sharing, exclusive material (on-demand videos, free online music magazine, exclusive tracks, in-studio performances), transfer to portable player
Rhapsody	track streaming, customised streaming	monthly subscription, with additional charge for CD burning	access music from any PC
MusicMatch	track streaming, customised streaming, à-la-carte downloads	one-off fee for MusicMatch Jukebox Plus, pay per song thereafter	transfer to portable players, personalise CD package, new music recommendations based on customer playlist
OD2 (branded by HMV, Fnac, MSN, etc.)	track streaming, à-la-carte downloads	pre-payment credits (activities such as downloads and streams have different credit value), pay per song, subscription	discounts for products paid with credits, transfer to portable player, news and special features with artists

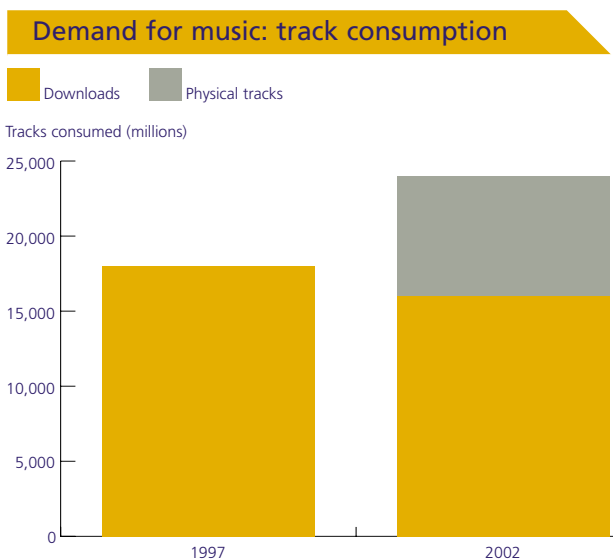
PlayLouder MSP plans to offer broadband access bundled with high-quality music services - whilst paying royalties to rights owners, songwriters and publishers - and allowing subscribers to freely exchange licensed music for a monthly fee. The service is currently under trial and it is expected to launch in the first quarter of 2004. Both services are experimental and appear to be aimed at specific niche markets.

Legitimate online music will also benefit new, independent services, as well as artist sites that offer paid-for content and build on communication between artists and music fans. During 2003, a number of artists have had considerable success offering downloads on their branded sites, including Madonna, Muse, Ben Folds and others.

Growth opportunities for legitimate online music

The opportunities the internet presents to the music industry are clear:

- > The demand for music is strong, and the internet is proving to be a popular medium to access it - especially for younger consumers. The prospect of converting unauthorised online music distribution into legal music downloads represents an important commercial opportunity. An IFPI survey conducted in Australia, Germany, UK, USA and Canada showed that total music consumption (legitimate physical formats plus all digital downloads) actually increased by 30% between 1997 and 2002. Total online consumption of music - the vast bulk of it unlicensed - amounted to approximately eight billion tracks in those countries alone - one third of all songs consumed.



Source: IFPI survey conducted in Australia, Germany, UK, US and Canada. Singles = 2 tracks; CDs and cassettes = 12 tracks

- > Surveys show that an increasing number of people are using or willing to use pay-for music services. In September 2002, an independent study⁴ of online music fans concluded that 36% of peer-to-peer users across Germany, France, Sweden, Spain and Italy, were willing to pay for music. In a study of visitors to its online sites in Europe about downloading, MTV discovered in summer 2003 that a third of online music fans - mostly under 25's - were willing to purchase downloads.
- > The music industry will be a beneficiary of the growing practice of paying for products and services online. In December 2003, the American Express Retail Index on internet shopping found that 54% of Americans were planning to use the internet to gift shop, with CDs and DVDs the second most popular category (82%) behind clothing (85%).
- > The uptake of broadband services has demonstrated that consumers are willing to pay a premium to improve their access to the internet. As broadband penetration expands, ISPs are increasingly looking to content such as music to attract and retain customers. In Europe, Tiscali, MSN, TDC and BT-Yahoo have all pursued this strategy. In the US, AOL (through MusicNet on AOL, Sessions@AOL and First Listen) has done the same - with considerable success.

“Our experience as a pan-European ISP tells us that consumers are moving away from the free internet access model, towards the paying model based on high quality connections like broadband. There are parallels to be drawn between this evolution and content distribution. Music fans will also be attracted to quality - and we are combining our strengths with the music industry to supply something which no unauthorised online service can ever provide: a comprehensive, safe, entertaining online music experience.”

Sergio Benoni, Head of Music, Tiscali (ISP)

4. Jupiter Research - Online Music in Europe, 2002.

Changing music consumption - How do you want to listen?

- **À-la-carte download** - most services allow users to pay a single fee for one song, which they download to their PC hard drive or to a portable music player.
- **Tethered download** - these allow consumers to 'rent' tracks for a given period of time. These tracks are non-transferable to portable music players, but sit on the consumers' PC hard drive until they 'time-out' or the subscription ends. These have been popular on European services and are a good way for consumers to preview songs before they decide to buy.
- **Download an album** - a popular option that enables consumers to pay a single fee for one album.
- **Download a bundle** - some services enable consumers to download a 'playlist' that has been suggested by other consumers, or perhaps the artist. Such 'bundles' may also include video content or artwork/photography.
- **Streaming** - allows the consumer to listen to a song once and is very low cost. Streaming is ideal for listening to exactly what you want without having to pay to own a copy of the song. It is the preferred option for consumers who want to explore a broad range of songs, artists or genres.
- **Customised streaming** - these services offer subscribers the ability to compile their own programme of tracks based on their favourite genre, artist, or choose an already compiled program.

“MSN Music Club is growing in popularity and this is to a large extent due to the increasing number of the very latest A-list releases that are available as digital downloads. This is what large proportions of the online audience want, and it clearly indicates to us that legitimate digital music services will have a mass market.”

Geoff Sutton, General Manager, MSN Europe (ISP)

Music to mobile networks and devices

Strong evidence emerged in 2003 that mobile networks and devices could become a key distribution platform for music over the next few years. The majority of activity in the sector so far has been promotional partnerships between mobile operators and music companies, allowing mobile subscribers to stream and sample new music as well as offering personalised artist-related material via the handset. The ring tones and mobile entertainment market first emerged in Japan and South Korea, where growth has been rapid.

Activity has spread throughout Asia and to Western Europe, and more recently reached the US. As 3G technology and handset penetration develops, new services including music content, and more specifically music downloads, are expected to launch.

In the latter part of 2003, mobile operators, record companies and music-related companies (such as MTV) formed a number of partnerships that lead to a wave of new services. In the UK, O2 launched its download to mobile service in November 2003, allowing mobile users to download music and transfer files to a player device manufactured by Siemens. In the US, Warner Music is the third major record company to make material available for Sprint Music Tones, a ring tone service, following a Sony Music deal in July 2003 and a Universal deal in January 2004. AT&T Wireless is set to launch its mMode service in 2004 using the handset as a channel for clips and full tracks downloadable to the PC.

Music to mobile will be boosted in 2004 by:

- Intensified activity by manufacturers and network operators in search of new business opportunities from entertainment content, met by the development of innovative products by music, film and game producers.
- Developments in 3G mobile technology enabling delivery of video to portable devices and the proliferation of Wi-Fi (wireless fidelity) 'hot-spots' with broadband capacity.
- Emergence of media-capable handsets such as the Nokia 7700.
- The development of wireless DRM enabling distribution of content across mobile operator's networks whilst protecting copyrighted content.

The Fight Against Online Music Piracy

The lure of 'free'

Although the development of an international online music market is now well underway, its progress has been hampered by unfair competition from illegitimate sites and services - that is, from online music piracy. A host of unauthorised internet sites and peer-to-peer services sprang up before legitimate services had a chance to set up, seducing many music lovers with the lure of 'free music'.

Why call them 'unauthorised'? Because these are sites and services that enable users to distribute and exchange digital files - not just music but also film, computer games, and pictures - without paying for them. Those who create the music and other products that are exchanged in this way have not agreed to their distribution and do not see a penny in return.

Some say the unauthorised services got their head start from an ingenious concept supported with clever technology. The truth is that the killer idea behind unauthorised music distribution is simply profiteering from other people's music. These services ignore all the requirements of a proper music business, and thus can operate with very little set-up or maintenance costs. They have achieved a system where they make millions of dollars from selling online advertising and bundled software on the back of music taken from someone else.

This has hurt sales of music worldwide, causing artist rosters to be cut and thousands of jobs to be lost, from the music shop assistant and the sound engineer to the band manager, songwriter and music journalist. Anyone who thinks that his or her illegal file-sharing or other unauthorised internet activity cannot affect sales is mistaken: in fact any such person's activity, combined with everyone else's, has a huge aggregate effect.

The nature of the problem

Unauthorised use of music on the internet takes a number of forms:

- > **Web, FTP and link sites.** The 'traditional' forms of internet infringement are still popular in many countries. Those involved may or may not profit from the activity, but often generate advertising revenue, user traffic and even notoriety for their activities.

- > **Commercial services.** A number of commercial services make money from their own copyright infringements and those of their users. Some charge users directly for access to unauthorised copies or streams of music. Others (like peer-to-peer services) claim not to copy music themselves, but encourage and assist users to steal music, and make money from advertising, spyware and other businesses built on the back of user infringements.
- > **Peer-to-peer (P2P) activities.** These involve direct transfers of music files and other material between users ('peers'), typically through a service that encourages and assists the activity. Users not only download music files from other peers' computers, but typically make files available for transmission to large numbers of other users.
- > **Increasingly sophisticated techniques.** As internet enforcement has ramped up, those engaged in infringement have developed increasingly devious techniques to avoid responsibility for their actions. These have involved encrypting various communications, using third parties' internet accounts, moving infringing files off-shore, and hiding their own identities through various technical means.

The size of the problem

Online piracy takes two dominant forms: distribution of files from unlicensed internet sites known as web and FTP sites; and peer-to-peer traffic on file-swapping services such as Kazaa, Grokster, Gnutella, WinMX and others.

IFPI estimates that the number of infringing music files on traditional web and FTP sites on the internet remained flat at approximately 100 million during 2003, while unauthorised files on peer-to-peer systems dropped by approximately 20% from their peak in April 2003 to approximately 800 million by the year's end. This has resulted in an estimated 900 million infringing music files on the internet as of January 2004.

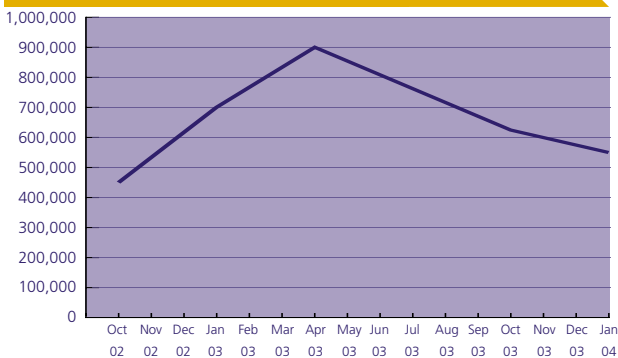
Infringing music files on the internet

	Apr 02	Apr 03	Jan 04
Web & FTP files	100 million	100 million	100 million
P2P files	500 million	1.0 billion	800 million
Total	600 million	1.1 billion	900 million
Infringing Web & FTP sites	200,000	200,000	200,000
P2P users offering infringing files (concurrent)	3.0 million	5.0 million	6.2 million

Source: IFPI

The most substantial change has been the drop in files on the peer-to-peer network FastTrack (Kazaa, Grokster, iMesh) that began in April 2003 and continued as the US recording industry group (RIAA) made public announcements of instant messaging, litigation warnings, and legal cases against users distributing large quantities of music files over the system. The number of simultaneous files on the FastTrack system dropped 33%, from approximately 900 million in April 2003 to approximately 600 million in January 2004, as reported by the FastTrack client software itself.

Concurrent files on FastTrack P2P service (m)



This trend has been confirmed by independent research firms. According to Nielsen NetRatings⁵, there was a 53% drop in use of the FastTrack network in the US between June and December 2003. Similarly, a report by Pew Internet & American Life and ComScore Media Metrix⁶ found that usage of leading peer-to-peer services (Kazaa, WinMX, BearShare and Grokster) declined in November 2003 from a year earlier. The user base of Kazaa dropped by 15% and Grokster fell 59% during that period, according to the report.

5. Internet Application Continues To Decline, September 2003.
6. America's Online Pursuit, December 2003.

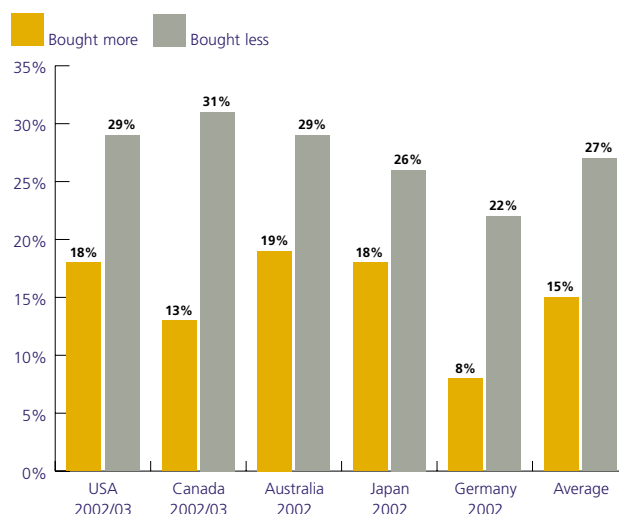
FastTrack also appears to have experienced declines in use outside the US during 2003, measured by the number of users and files that its system reported to be online during off-peak (i.e. overnight) hours in the US - times when European and other non-US usage would be the highest. Between June and December 2003 the FastTrack network experienced a drop of approximately 28% in concurrent files available at off-peak US times, which was nearly the same drop seen in peak US times during the same period. This indicates that the widespread reports of legal actions against US 'uploaders' had a deterrent effect on users of the FastTrack network in other countries as well.

There appears to have been some growth in other regions and on other peer-to-peer systems where litigation has not been focussed so far, but to date this has been outweighed by the decline in the files available on FastTrack, by far the largest peer-to-peer network.

The impact: unauthorised file-swapping hurts sales more than it promotes them

It is a frequent misconception that illegal internet distribution promotes legitimate sales of music. In fact, studies in 2002 in five major music markets - US, Canada, Germany, Japan and Australia - showed that illegal downloading and burning have a clear negative impact on consumers' music purchases. On average, 27% of respondents among all the surveys stated that their spending on CDs and similar music purchases had decreased since they began downloading illegally distributed music, compared with 15% who said that their spending had increased.

Impact of downloading & burning on sales



Sources: RIAA/Hart Research, CRIA/Solutions Research Group, ARIA/Quantum Market Research, RIAJ, GfK.

The industry response

The record industry sharply stepped up its response to the growth of internet piracy in 2003. Initiatives took place on four fronts:

1. Technological protection of copyrighted music.
2. Public awareness programmes highlighting the illegality of file-swapping and the damage it inflicts on people across the music sector; combined with the promotion of legal alternative services.
3. Co-operation with ISPs.
4. Litigation directed both at unauthorised file-swapping services and at hundreds of individuals illegally offering and distributing substantial quantities of music files online.

1. Protection through technology

As the technology used to create and play music evolves, so does the role of technology in protecting music against unauthorised copying and distribution.

Music must be protected in two distinct ways. Prior to release, recordings need to be handled securely to avoid early leaks. After release, music must be protected from unauthorised mass copying while giving consumers a wide range of options for enjoying it.

Pre-release security

Increasingly sophisticated security is needed to protect against unauthorised leaks - that is, the stealing and distribution of recordings on the internet prior to their planned release. Pre-release piracy can force an earlier than planned release, disrupt tour dates and marketing or advertising plans, hurt the all-important initial album sales and compound the losses due to substitution by unauthorised copies.

Leaks of albums from bands such as Metallica and Korn led to their release dates being advanced by several weeks, because the leaked copies circulated were of poor quality with the wrong mixes and in the wrong order.

Post-release protection

Digital Rights Management (DRM) technologies are critical to the development of new music services because without them music content is vulnerable. It is possible to burn as many as 200 albums onto multiple CD-R discs in less time that it takes to record a single C90 cassette. Combined with internet

file-swapping, digital copying can then be transformed into unlimited distribution at the touch of a button. DRM protects against this, while allowing online stores to offer the consumer a wide range of options including streaming, track rental, track purchase or 'burn to CD-R'.

Copy control technologies (CCT) are also being used by record companies. These have already proved instrumental in the DVD Video format, as well as in computer games and software. But CCT is now evolving further than simply preventing copying. Despite some initial technical and legal hurdles, by integrating DRM flexibility with CCT protection, flexible usage of the protected CD is now becoming possible - for example by allowing the 'burning' of a protected copy, or by allowing the transfer of DRM-protected music files from the CD to a PC jukebox or portable digital player.

Damage control

Among other things, legitimate technologies now allow options such as making alternative ('decoy') files available on otherwise infringing systems - a self-help measure that some record companies have taken. Technology itself thus can provide important tools for increasingly effective action against infringement on the internet.

“As a retailer I feel very strongly about the effect internet piracy is having on music stores and their employees in Canada and indeed around the world. Stealing music on the internet is no different from stealing a pair of shoes, and we have to carry this argument to its logical conclusion. The social contract on which our society is based is rooted in respect for the law.”

Natalie Lariviere, President and CEO of Groupe Archambault Inc. (Canadian retailer)

2. Public awareness campaigns

The music industry conducted an intense global information campaign in 2003, with the aim of explaining the illegality of unauthorised online music distribution. These activities are designed to highlight how new legal online services are developing, as well as how online copyright theft hurts people working across the music sector. Campaigns have ranged from music coalition websites, public relations and advertising campaigns, university and school projects and messages sent directly to people using unauthorised services.

These campaigns, coupled with the launch of extensively publicised lawsuits against major copyright offenders in the US, have had a decisive impact in raising public awareness on the issue internationally.

The new figures released by IFPI show that the general public has a very high level of awareness that unauthorised file-swapping is illegal, indicating that the industry's public education activities have indeed had an effect.

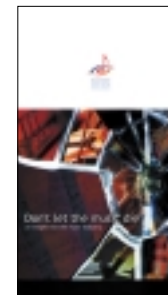
Multi-media campaigns

Summer 2003 saw an alliance of music sector groups launch www.pro-music.org (see page 18), a website aimed at promoting legitimate online music services and confronting the myths surrounding online music piracy. The website is supported by six international organisations - FIM, GIART, ICMP-CIEM, IFPI, Impala and GERA-Europe - representing musicians, publishers, performers, artists, major and independent record companies, producers and retailers across the music industry. A national version of pro-music has been launched in Germany, and in France with the support of the French government, with other countries to follow suit.

Many other countries have launched national websites, along with advertisements, CD inserts or education tools. Canada's 'Keep Music Coming' campaign, for example, uses all these media to inform young Canadians that when people buy music, they help artists create more music and give new artists a chance to be heard.

The 'Get It Right!' educational campaign of the Netherlands' broad-based copyright coalition - involving the Ministry of Justice and representatives of copyright industries - aims to teach the value of copyright to 14-15 year olds. The education pack, which includes a video with Dutch rock band Di-rect, a magazine and an interactive website, helps teachers introduce the subject of copyright to their pupils by taking them through the process by which certain products like books, newspapers, film, websites and music are created.

The Singaporean 'Don't let the Music Die' video has been distributed to almost 200 educational institutions, and clips from the video broadcast on television. Singapore's largest broadcaster has also run television and radio commercials as part of the 'Keep the Music Alive' campaign.



Singapore's 'Keep the Music Alive' website and educational video package

Other countries took out advertising to reach consumers, including:

- > Japan, where five other industry groups joined the recording industry's 'Respect Our Music' ad.
- > Belgium with their 'Please Don't Steal Music. Just because you can doesn't mean you should.' ads.
- > Canada with two recent advertising spots 'Virus' and 'Jimmy's Room'.

Information to students and employees

File-sharing activities have become a serious concern to companies and universities as peer-to-peer applications quickly consume their bandwidth. There are reported examples in universities around the world where virtually all of the institutions' bandwidth had been taken over by peer-to-peer traffic, affecting those who depend on these resources to study and work. For example, Lund University in Sweden reported in April 2003 that it had blocked all access to peer-to-peer ports, given that peer-to-peer traffic had slowed its university network dramatically.

IFPI's Copyright Use and Security Guides were mailed to thousands of companies, government departments and educational institutions in 21 countries in early 2003. They call on administrators of computer networks within government, private companies and educational establishments to advise employees and students against copyright misuse on computer systems, in particular copying and uploading copyright material to the internet without permission from the rights owner. The guides advise these groups of the security and legal risks they run when copyright material is copied and transmitted without permission.

The distribution of the brochures to academic institutions was the start of a greater co-operation between the music industry and universities around the world.



The Copyright Use and Security Guide brochures

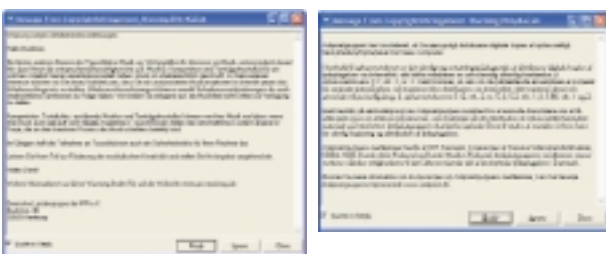
Many schools and universities have taken steps to discourage illicit file-swapping activity, imposing bandwidth limits, sending warning notices, using filtering and other technical tools, and disconnecting users that trade copyrighted music unlawfully.

In Italy, schools have been requested by their regional educational authorities to adopt copyright protection measures, which include technical tools to prevent the use of unauthorised music files on the institutions' servers.

Most recently, universities in the US have begun giving crash courses in copyright law and at least one has already begun to offer legitimate music services along with cable television, free newspapers, and other perks of campus life when students begin their university term.

Instant messaging: reaching file-swappers directly

Users illegally distributing music online can also be reached directly. For several months the recording industry has been sending instant messages over peer-to-peer systems to users who appear to be offering unlicensed music. These warn users that they should not engage in copyright infringement and explain why using lawful copies of music is so important.



Since April 2003, the RIAA has sent approximately 18 million instant message warnings to peer-to-peer users in the US. Virtually all of the users sued by RIAA for making infringing copies of recorded music available on peer-to-peer services had been sent such a message.

Record industry groups in five other countries - Australia, Austria, Canada, Denmark, Germany - have sent nearly two million instant messages to peer-to-peer users since August 2003.

Following is a sample of the instant messages sent:

- > **Austria:** ACHTUNG! Sie bieten geschützte Musikfiles ohne Zustimmung der Rechteinhaber über eine Internet-Tauschbörse an...
- > **Australia:** INTERNET FILE SHARING IS THEFT. IT ROBS ARTISTS AND SONGWRITERS OF INCOME AND REDUCES THE AVAILABILITY OF NEW MUSIC. Copyright owners are aware that you may be offering copyrighted music from your computer via a file-sharing network...
- > **Canada:** WARNING: It appears that you are offering copyrighted music to others from your computer...
- > **Denmark:** Antipiratgruppen har konstateret, at De øjensynligt er i færd med at kopiere ophavsretligt beskyttede lydoptagelser...
- > **Germany:** Warnung wegen Urheberrechtsverletzungen. Hallo Musikfan, Sie bieten anderen Nutzern der Tauschbörse Musik an...

3. Co-operation with internet operators for high-volume take-down

Much of the industry's internet anti-piracy work takes place as a co-operative effort with ISPs. This is in the interest not only of the music business but also of ISPs, who do not want their systems used for activities that are illegal, that clog the internet service or subject it to security problems.

Most ISPs' terms of service expressly prohibit their customers from engaging in copyright infringement, or from running servers (such as peer-to-peer servers) from individual accounts. ISP agreements also typically provide that they may remove, block or take other action to stop such activities, and co-operate with enforcement efforts to do so.

For many years, IFPI and more than 25 national groups have notified ISPs when unauthorised music files or other infringing activities appeared on those ISPs' services. In the vast majority of cases, they have voluntarily blocked or taken down the sites or files identified as infringing. Given that no legal proceedings or other formal procedures are required, this has proved an efficient and cost-effective way of removing high-volume infringing material.

The number of music files removed from the internet and infringing sites taken down thanks to voluntary action by the ISPs once notified continues to increase year-on-year.

In 2003, IFPI secured the take-down of approximately 41,000 unauthorised web and FTP sites, 1,050 peer-to-peer indexing servers, and 1.6 billion unauthorised copies of recorded music from the internet in 101 countries worldwide.

Infringing files removed from the internet			
	2001	2002	2003
ISP notice & take down	700 million	1.3 billion	1.6 billion
P2P files, Web & FTP sites taken down	28,000	38,000	41,000

Source: IFPI

4. Litigation raising awareness and achieving deterrence

Persistent online infringement

Litigation has proved highly effective when cooperation and public awareness are not enough to reduce unauthorised online music activities. . Examples of potential targets for litigation are:

- > **Unscrupulous businesses** that may have a strong financial incentive to conduct online infringement or encourage users to do so. Such services sometimes will not stop infringements or act responsibly unless forced to do so by law enforcement authorities or the courts.
- > **Unauthorised web, FTP or other sites which are overtly commercial** but which may for ideological reasons spend substantial amounts of time, money and effort to maintain pirate sites, disguise or move them to avoid the law, and resist take-downs or legal actions to stop them.
- > **Individual users who don't get the message.** The idea of taking or distributing someone else's music for free on the internet is a seductive one that may need a tougher deterrent response. Even users fully aware that online infringement is stealing may believe that they will never get caught or face any real consequences, and thus persist in illegal behaviour.

Legal action against services and unauthorised sites

Cases against unauthorised sites are brought in countries all around the world, as the laws everywhere already provide a basis for stopping unauthorised internet copying, transmission and/or distribution.

While such cases may be difficult or prolonged, they are having an overall deterrent effect. The following are examples of the types of cases that have been brought:

Services

- > **MMO peer-to-peer service (Japan).** The final judgement entered in December 2003 found this service itself to have infringed. An injunction was entered against the service, and compensation awarded to the record company and music publisher parties.
- > **Soribada peer-to-peer service (Korea).** The court entered an injunction in July 2002 requiring this service to stop letting users download the plaintiff record companies' copyrighted recordings.
- > **Weblisten (Spain).** First-and second-instance courts have entered injunctions against Weblisten (subject to appeal) for unauthorised use of plaintiff record companies' recordings in its streaming and download service.
- > **MP3.com, Aimster, Kazaa, Grokster (US).** The US industry has brought a range of litigation case against peer-to-peer and other online services that have not secured licences for copyrighted recordings of music.

Web, FTP, Link Sites

- > **Mp3WmaLand (Australia).** The criminal court convicted three individuals in November 2003 for running a complex web of 'free' download sites offering an estimated AUD 60 million in recorded music.
- > **Bruvik/Napster.No (Norway).** In this case brought by recording industry and music publisher plaintiffs, the site was found liable in January 2003 for offering 'links' to unauthorised copies of recorded music (no relation to the original Napster company or case).

Actions against individual infringers

Litigation against high-volume individual distribution is an important option of last resort in the fight against internet piracy. Civil or criminal lawsuits against commercial, persistent or major individual infringers provide a crucial public deterrent. Even some of the biggest critics of the record industry have admitted this:

Mr. [Joe] Kraus [of DigitalConsumer.org] agreed that existing laws should be enforced suggesting that some high-profile prosecutions of major violators could "make consumers feel more vulnerable" and more likely to seek out legitimate sources of online content.

'Customers, Not Technology, Seen as Key for Digital Music'. T R Daily.

[Fred] Von Lohmann [of the Electronic Frontier Foundation] said it was "not such a radical statement" to say piracy suits would be more appropriately aimed at consumers than enabling technology companies... A few targeted lawsuits would get the message across.

'Copyright'. Washington Internet Daily.

The US record industry in 2003 began to enforce the copyright law against individuals. These were not people who had casually downloaded a few files for their own personal or private use. They were individuals alleged to have copied hundreds or thousands of music files onto their personal computers and opened their directory of files to the internet for copying, transmission and distribution to potentially millions of anonymous strangers.

Lawsuits against major 'uploaders' of copyrighted music - a successful deterrence strategy

The lawsuits against substantial 'uploaders', first launched in September 2003 in the US, have got the message across to a vast audience in the US and abroad. Awareness of the illegality of unauthorised file-swapping in the US rose from 37% before the lawsuits to 64% in December 2003.

The message has reached companies and universities, as well as children and parents. There is growing awareness, especially in the US, that the 'sharing' activity sometimes portrayed as harmless or even respectable by peer-to-peer services is in fact illegal and raises a raft of other concerns about security and other content of such services.

Although their primary intent was to create a deterrent via public awareness, the US legal actions have also helped give breathing room to legitimate online services. And there appears to have been a significant reduction in the levels of online piracy in the wake of the litigation campaign. At the same time subscriptions to legitimate online services in the US have risen sharply.

New IFPI survey shows the deterrence effect can work internationally

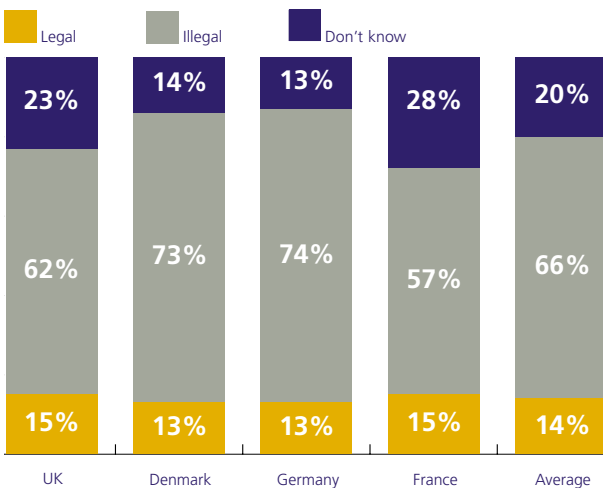
In December 2003 IFPI commissioned a survey to determine the level of public awareness of illegality of distributing or sharing unlicensed music files over the internet, awareness of legitimate online music services, and support levels for legal action. Research firm GfK conducted the survey using random sample computer assisted telephone interviews. The sample sizes were 1,000 in Germany, France and UK and 500 in Denmark.

The main findings and conclusions from the survey results are:

- An average of 66% of surveyed respondents in the four countries are aware that unauthorised file-swapping is illegal. This is even higher than the corresponding levels of awareness in the US (64%) in December 2003, after three waves of US lawsuits against individuals.
- More than half the people surveyed (54%) in the four countries support the industry's legal actions against major internet infringers. Support is highest in Denmark (59%) and Germany (60%) where awareness of the illegality of file-swapping is also greatest. In France and the UK, the support figures are 49% and 52% respectively, with almost a quarter of consumers undecided whether to support the legal action.
- Litigation has played a critical role internationally in improving the public's awareness that file-swapping is illegal. Awareness of illegality of file-swapping is higher among people who have heard that the industry has taken legal actions against file-swapping services and users. An average of 59% of people surveyed were aware of announcements about such legal actions.

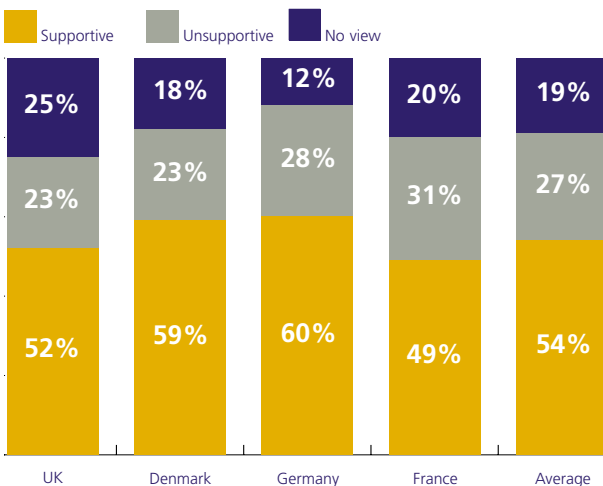
- > Half of all respondents (53%) think that the prospect of legal action by music copyright holders would make illegal file-swappers stop or reduce their activities.
- > Awareness of legitimate alternatives to file-swapping is still low, at 23% among all respondents. The 16-29 year olds are however more aware; 38% are aware of legitimate online music services.

Awareness of illegality of file-swapping



Question: "As you may know, there are technologies available on the internet that individuals can use to distribute or share music from their computer to other people for free. From what you know about the current laws, is it: 1) legal all the time 2) legal most of the times 3) illegal most of the times, 4) illegal all the time, 5) Don't know."

Level of support for legal action



Question: "If you were to hear news that the recording industry in (this country) is taking legal action against (nationality) individuals illegally sharing substantial amounts of copyrighted music online, would you say that you are: 1) Supportive 2) Unsupportive 3) No view."

Litigation as a global strategy

Litigation has proved a successful strategy that is increasingly likely to be needed internationally. As growing broadband penetration spurs an increase in unauthorised music distribution, it is likely that there will be lawsuits against major internet distributors internationally in 2004, similar to those filed in the US.

Several countries have already taken selected cases against individuals offering music files without authorisation. These include:

- > Denmark. Civil claims against 150 peer-to-peer users in December 2002.
- > Germany. Criminal raid against peer-to-peer uploader and server operator in April 2003.
- > Italy. Criminal raids of 75 peer-to-peer uploaders and server operators in May 2003.
- > Switzerland. Criminal conviction of uploader on peer-to-peer service, May 2003.
- > Taiwan. Criminal prosecutions of peer-to-peer users pending.
- > Korea. Criminal complaints filed against 100 peer-to-peer users, December 2003.

The industry's willingness to bring lawsuits, alongside its educational and commercial initiatives to promote good commercial and legal online alternatives, should not be doubted. The recording industry has already demonstrated that is prepared to enforce its rights against major infringing uploaders on the internet where necessary.

"We at Fnac have the ambition to become a major player in the digital distribution of music. We are convinced that the market is now ready for legitimate download services and there is evidence to support this. However for the market to really take off it is crucial to fight against piracy - largely responsible for the decline in music sales - as well as giving consumers a really attractive and efficient service."

Christophe Cuvillier, Directeur General International et Developpement, Fnac (French retailer)



“Making available copyrighted music without permission on the internet - that means the bulk of all file-sharing - is illegal in virtually every country of the world. Those who ignore this legal reality may have to face the consequences.”

Jay Berman, Chairman & CEO, IFPI

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ONLINE MUSIC NEWS

- ▶ MusicRebellion.Com ends Phase I of Dynamic Pricing 5 January 2004
- ▶ MusicRebellion.com offers 10 cent downloads 5 January 2004
- ▶ O2 launches 'O2 Music' 10 November 2003
- ▶ Entertainment UK launches music download 13 November 2003
- ▶ New one-stop-shop for webcast licensing 11 November 2003
- ▶ Playlouder MSP - first ISP to pay royalties 27 October 2003

Voices of the music sector

music online
 Download music from these sites

THIS SITE SPREADS THE HOPE OF 46664.COM

- ▶ Myths about free music exploded
- ▶ Reset peer-to-peer software to be legal
- ▶ Questions answered on copyright and the law
- ▶ UK record industry chief speaks out
- ▶ See the timeline of events for online music
- ▶ Making it easier to buy than steal: Larry Kenswil
- ▶ Check out our list of retailers and 'e-tailers'
- ▶ Here's a list of download sites in the USA
- ▶ Who suffers when music is illegally copied?
- ▶ Steve Lillywhite reveals what it takes to be a producer

Email info@pro-music.org with details of planned or existing legitimate online music services



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