

NO LONGER JUST FOR DIAMONDS IN THE ROUGH

How Media Companies Mask Cartel Structures with the Veil of Copyright to Protect Their Dying Industries

ANDREW M. KULPA
Vanderbilt University Law School

2123 Fairfax, Apt. 13
Nashville, TN 37212
Andrew.Kulpa@Vanderbilt.edu
(615) 498 – 3819

Abstract	A
Author’s Biography	B
Introduction	1
I. Technological and Digital Distribution Evolutions	2
II. Content Distribution and Piracy Battle Plans	4
III. Industry Power Structures Drive Regulations and Norms	7
A. Identifying Industry Power Structures	7
B. Fitting an Elephants through the Eye of a Needle	10
C. What’s Normal	11
IV. Barriers Are Being Erected on all Fronts	13
A. Preserve and Protect	14
B. Damage Done	17
C. Using Copyright Laws to Increase the Stranglehold	20
V. Structuring the Right to Buy	21
A. We Will Pay for Our Freedoms, Thank You	22
E. Miss the Boat and You May Fall Off the Face of the Earth	23
VI. Don’t Look the Other Way, Act a Different Way	26
A. The Basic Framework	27
B. Protecting the Creators	29
C. Technology Strategies	29
D. Structural and Supply Chain Integration	31
E. Disputes Will Arise	32
F. Show Me the Money	33
Conclusion	35
Appendix A. DVD Growth 1998-2003	39
Appendix B – A-La-Carte Pricing in a Mixed Bundle Environment	40

Abstract

The rapid turnover and acceptance of technology advancements have driven down their cost to consumers. This has led to improvements in content delivery mechanisms, which in turn, allows media distributors to place a premium on the consumer's freedom to choose the means of media delivery. However, traditional media distributors such as the music, movie, and television industries have rejected new business models based on these technology advancements. Additionally, the Dot-Com Era instilled society with a burdensome set of social norms such that computer piracy is becoming accepted as a victimless crime; a view staunchly rejected by artists and copyright holders. In an attempt to preserve their cartel structure, media companies have adopted a strategy of legal and governmental action that has driven consumers from the marketplace. Finally, the media industry's oligopoly cannot exist and grow in a free market economy such as the U.S. Therefore, traditional media must consider the shifting trends and market threats in order to protect their creative content and realign social norms achievable by utilizing better management of the content supply chain.

Author Biography

J.D. Candidate, Vanderbilt University Law School, 2005; M.B.A, Wayne State University, 2004; B.S., University of Michigan, 2001. Executive Editor, Vanderbilt Journal of Entertainment Law and Practice, 2004-2005. The author greatly appreciates the assistance and expertise of Professor Steven Hetcher at Vanderbilt University Law School; Professor Bruce Lynskey at Vanderbilt University Owen Graduate School of Management; and Professor William Spaulding at Wayne State University School of Business Administration for their assistance in understanding the business and legal implications within media, mature, and high growth industries.

Introduction

Not even the Fountain of Youth will let an industry cheat death. As demanding people, society constantly seeks efficiency, advancement, and change in industry in order to persist. Technological advancement represents a prime example of this evolutionary trend. While technology based products were initially considered large capital investments, upgrades and obsolescence now encompass life cycles so short they are simply rolled into the cost of doing business¹. On the consumer end of the spectrum, the rapid turnover in technology has driven down costs and made cutting-edge access to the digital world accessible to the masses². Technology advancements have not only led to wide scale accessibility, but also improvements in content delivery mechanisms. As the content delivery systems have improved in efficiency and become more accessible to a wider range of audiences the ability to provide on-demand media has permitted distributors to place a premium on the freedom of choice. However, the premium cost has not been adopted in all cases, especially in traditional music, movie, and television distribution, but these industries have not curbed the demand for such advancements.

Society has developed a burdensome set of social norms. With the advent of large-scale file sharing and publicity surrounding peer-to-peer (P2P) systems, society shifted to the mentality that computer piracy was perfectly acceptable because it was a victimless crime. However, copyright holders contest they were as much a victim as in any robbery. The copyright holder's needs began to be addressed by media studios and representative

¹ Within slow computing organizations such as government agencies, the expected life cycle of desktops is 4-5 years and laptops 2-3 years with a 20% failure rate.

PC Life Cycles: Guidelines for Establishing Life Cycles for Personal Computers, Texas Department of Information Resources, 5-6 (Jan. 2003) <<http://www.dir.state.tx.us/eod/pc/pc-cycle.pdf>>.

² As of March 18, 2004, 74.9% of consumers above the age of two had access to the Internet.

Web Access at 75 Percent, Wired News (March 18, 2004)

<http://www.wired.com/news/culture/0,1284,62712,00.html?tw=wn_tophead_5>.

groups such as the Recording Industry Association of America (RIAA) and the Motion Picture Association of America (MPAA) largely through a series of threats, lobbyist actions, and lawsuits. In lieu of all the money being filtered through the legal and political system, the social norms were not shifted into a model that could meet both the consumer and copyright holder's needs. This has long been an issue vocalized by consumers, but rarely addressed by media groups. At the root of all this is the media industries inability to recognize their imminent death as a result of failure to adequately maximize their competitive advantages in representing their constituents.

When dealing with large, intertwined industries like movie and music companies, the onus must be placed on the distributors and representative groups to harness changes in technology; not only to protect, but to disseminate artists' works. The media companies have adopted a strategy of legal and governmental action which has driven consumers from the marketplace in an attempt to brainwash consumer thought. The copyright holders and their representative groups must consider both the present results and side effects of their current tactics in calculating a future strategy. It is essential they protect their creative content and realign social norms by utilizing market trends and technological advances to better manage the content supply chain and preserve industry growth.

I. Technological and Digital Distribution Evolutions

Over the course of time technology advancements and relaxed federal regulation have had grandiose effects on the media and content delivery industries. The cable industry, for example, has propelled growth through market forces. Beginning in the 1980s, the cable industry experienced rapid growth resulting from market deregulation and

the introduction of new technology, namely satellite-delivered cable systems³. As a result, cable has emerged as a fifty-one billion dollar a year industry with nearly seventy-four million users in the United States⁴ and has experienced an 80% growth rate between 1992 and 2003⁵. The movie industry is another industry that has benefited from similar factors.

The movie industry, while lagging as of late, has experienced remarkable growth with the introduction of new technology. The movie industry has a viewer base where, “Over 70% of the population rents or goes to movies regularly, thus accounting for over 1.5 billion movie attendances each year in the U.S.,” as of 2001⁶. Home movie sales on VHS and DVD have also significantly increased revenue for the movie studios. In 2004, home video purchases were up an additional 15% from 2003 and estimated to close out the year at approximately \$16.5 billion in sales⁷. DVD sales alone have experienced a growth thirty times over between 1998 and 2003⁸. Some argue access to these revenue streams would not be permitted at all had the prediction of Jack Valenti, then president of the MPAA, before the U.S. Senate in 1984 had come true. Mr. Valenti, in referring to the advent of Sony Corporation’s Betamax machine such that, “the VCR is to the American film producer and the American public as the Boston strangler is to the woman home

³ Roni Mueller & Gretchen Wattig, *The "New" Series Co-Production Deal in Network Series Television*, 31 Sw. U. L. Rev. 627, 655 (2002).

⁴ *Industry Overview: Statistics & Resources*, National Cable and Telecommunications Association (May 2004) <<http://www.ncta.com/Docs/PageContent.cfm?pageID=86>>.

⁵ Jim Trautman, *Cable's Economic Influence Grows*, National Cable and Telecommunications Association (August 11, 2003) <<http://www.ncta.com/Docs/PageContent.cfm?pageID=325>>.

⁶ James Jaeger, *The Movie Industry*, Matrixx Entertainment Corporations (visited Nov. 3, 2004) <<http://www.mecfilms.com/moviepubs/memos/moviein.htm>>.

⁷ Thomas K. Arnold, *DVD Update*, *The Hollywood Reporter* (Oct. 14, 2004) <http://www.hollywoodreporter.com/thr/television/feature_display.jsp?vnu_content_id=1000672279>.

⁸ See Appendix A.

alone.⁹” This prophecy was not accepted by the Supreme Court¹⁰ and now advances in technology are feeding the media industries. Yet, as if history needed to be re-mastered, the story is being re-released.

II. Content Distribution and Piracy Battle Plans

While evolutions and advancements in technology have brought forth growth for the media industries, one major wide-scale advancement has also lead to an insurmountable task for content distributors. That advancement is the accessibility to the Internet and cyberspace.

The Internet, or more generally, computers sharing processes via communication channels have been in existence for many years. Between 1977 and 1978, the first Bulletin Board Service (BBS) was introduced, which allowed anyone with a computer and a modem to connect to another computer and download files¹¹. It may be argued that since that time, the scope of the architecture has not changed, but rather the scale of the distribution system. While users no longer depend on direct connections from one computer to the other, users still generally use their computers to explore countless files and information existing in a world built not on brick and mortar, but rather electron transfer. One-to-one BBS connections have been replaced by a global network of servers, routers, hubs, and PCs. Most importantly, the ease of use and related, complex marketing trends have brought what was once a mostly underground system into the mainstream.

⁹ *20th Anniversary of Betamax: the Court Case that Brought You the VCR*, Public Knowledge (visited Nov. 3, 2004) <<http://www.publicknowledge.org/content/cases/betamax%20case/>>.

¹⁰ See generally, *Sony Corporation of America v. Universal City Studios, Inc.*, 464 U.S. 417 (1984).

¹¹ See generally, Henry Edward Hardy, *The History of the Net* (Sept. 28, 1993) (unpublished Master's thesis, Grand Valley State University) (available at <http://china.si.umich.edu/econ495/docs/hardy_net.history.txt>).

Unfortunately the problems that existed in the digital underground still exists in the mainstream Internet; users are trading copyrighted material with complete disregard for the copyright holder's rights. This issue is one the movie and music industries did not face during the BBS era; however the software industry has been through it before.

The software industry has had to deal with piracy via underground trading for years. In 1996, the software industry estimated a \$2.3 billion loss in the U.S. and \$11.3 billion loss globally as a result of piracy¹². As of 2002 the numbers decreased to an estimated \$2 billion in lost revenue in the U.S., but \$13 billion globally¹³. These numbers represent a piracy rate over three times larger than that estimated by the music or movie industry¹⁴. In lieu of this, the software industry has not made the mistake of leading a campaign to annihilate all potential home pirates as in the music and movie industry. The reason the software industry has more experienced in dealing with piracy is because of their product's format; software has always been digital, making it very easy to copy¹⁵. Similar to what the media industries are now experiencing, software can be easily reproduced and the second copy is exactly the same as the original. Further, in the software industry, as new technology, copying methods, and communication methods have emerged, they have not fought to subdue these upgrades, but rather use them to operate more efficiently and to decrease their overall operating costs.

¹² Michael Coblenz, *Intellectual Property Crimes*, 9 Alb. L.J. Sci. & Tech. 235, 240 n.12 (1999).

¹³ *Software Piracy Fact Sheet*, Business Software Alliance, pg. 1 (visited Nov. 3, 2004) <<http://www.bsa.org/resources/loader.cfm?url=/commonspot/security/getfile.cfm&pageid=1292&hitboxdone=yes>>.

¹⁴ *Anti-Piracy*, Recording Industry Association of America (visited Nov. 4, 2004) <<http://www.riaa.com/issues/piracy/default.asp>>.

¹⁵ Tanya Poth, *The Computer Piracy Superhighway*, 28 Denv. J. Int'l L. & Pol'y 469, 472 (2000).

To balance consumer demand and copyright protection, the software industry has taken a multi-tiered approach to curbing piracy¹⁶. First, they have created international organizations to raise awareness as to relevant intellectual property issues¹⁷. Second, they have used existing technology to increase security features associated with the use and distribution of software¹⁸. Third, the software industry has created trade groups focused on education, amnesty, and litigation of piracy related issues¹⁹. This multi-tiered approach in conjunction with revised business models has had a distinct impact on lowering software piracy rates²⁰. The Business Software Alliance (BSA) is the primary trade group for the software industry in relation to software piracy. The:

BSA stated that piracy rates have been falling modestly since 1994. The organization discusses several reasons for the decline, including lowering the price of commercial software to make it more affordable. Also, governments are taking a more active role in protecting intellectual property rights within their own borders and in relation to international trade²¹

This approach may sound similar to the method pursued by the movie and music industry. So why has the result been different? Why have piracy rates been growing in the visual and audio media markets while falling in the software realm? There are a number of distinguishing factors which must be addressed in order to understand the dichotomy.

¹⁶ *Id.* at 483.

¹⁷ *Id.* at 484-485.

¹⁸ *Id.* at 486-487.

¹⁹ *Id.* at 487-490.

²⁰ *Id.* at 491.

²¹ *Id.*

III. Industry Power Structures Drive Regulation and Norms

There are a number of factors that distinguish the software industry and their effort to stop piracy from that of the music and movie industry. Many of the major issues are rooted in current social norms and the manner of strategy execution, but the most important factors relate to the manner in which the industries operate.

A. Identifying Industry Power Structures

One major distinguishing factor between the battle over copyrights in the software and media industries is the number of competitors within the market place. The software industry is able to adjust its operating model based on a competitive, free market economy approach defined by:

dynamic, vigorous competition... [where] the early entrants into a new software category quickly captures a lion's share of the sales, while other products in the category are either driven out altogether or relegated to niche positions. What eventually displaces the leader is often not competition from another product within the same software category, but rather a technological advance that renders the boundaries defining the category obsolete.²²

While it may be contended that this view is a static market analysis, in the software industry, the overall barriers to entry are low based on substitute products, seller power, buyer power, and the sheer number of new entrants²³. Considering the media industries' model the free market economy approach does not provide scale as in the software industry.

²² Joshua A. Newberg, *Antitrust for the Economy of Ideas: The Logic of Technology Markets*, 14 Harv. J. Law & Tec 83, 132 (2000), citing *United States v. Microsoft*, 65 F. Supp 2d 1, 16 (D.D.C. 1999).

²³ Juho Lindman, *Effects of Open Source Software on the Business Patterns of Software Industry* 25 (Fall 2004) (unpublished master's thesis, Helsinki School of Economics Department of Management) (available at <<http://www.greywolves.org/~deltax/gradu.rtf>>).

One popular mentality advocated is that the music and movie industries operate under a monopolistic model and use this power to exert strength over governmental and social choice²⁴. In his book *Free Culture* Lawrence Lessig presents this idea on numerous occasions²⁵. Mr. Lessig states powerful arguments in regard to this approach, however, there is one major flaw in this presentation; the media industries do not fit into a standard monopolistic model. Traditional media operates as an oligopoly. This distinction is not simply rhetoric and must be examined carefully in order to better understand the operating regime.

Since the software industry is operating based on a free market economy model, prices are set by auction²⁶. In this model, market place pricing is set by what the consumers are willing to pay compared to the relative competition²⁷. As new entrants move into the market, prices are distinguished by supply and demand as well as competitive behavior and competitive positioning or product differentiation²⁸. In the software industry, through the use of technology and the market progress, the experience curve has shifted and firms have become both more effective and efficient. However, monopolies and oligopolies are infused with inherently different operations.

²⁴ LAWRENCE LESSIG, *FREE CULTURE* 88-94 (Penguin Books 2004).

²⁵ *Id.*

²⁶ Interview with William Spaulding, Lecturer of Management, Wayne State University School of Business Administration, in Detroit, MI (May 24, 2004).

²⁷ MICHAEL HITT ET AL., *STRATEGIC MANAGEMENT* 57 (6th ed., Thompson Pub. 2004).

²⁸ *Id.* at 56-59.

In a monopoly in the U.S., there are not one, but rather two primary players; the firm in question and the government²⁹. In a monopoly there may be relatively inelastic demand curves meaning that consumer demand does not fluctuate significantly based on product price³⁰. However in a true monopolistic market in the U.S., the government has the right to regulate change or decline a change in pricing³¹. On the other hand, an oligopoly consists of relatively few competitors where pricing and strategic decisions by one firm directly affect the output of other firms³². When analyzing markets operating as an oligopoly, it is apparent there are profit incentives for the firms to cooperate in the decision-making process, which in turn could lead to collusion³³. So why is this distinction important in the media industries? Namely because of the power an oligopoly industry possesses over a monopolistic industry.

A monopoly that seeks to exclude firms from the market or impair their ability to compete cannot exist unless it is regulated by the government³⁴. Therefore, regulated monopolies, such as utilities, have their prices set by the government³⁵. An oligopoly also exhibits what is commonly known as monopolistic tendencies, however, since there are

²⁹ Interview with William Spaulding, Lecturer of Management, Wayne State University School of Business Administration, in Detroit, MI (May 31, 2004).

³⁰ WILLIAM A. MCEACHERN, MICROECONOMICS 200 (5th ed., Thompson Pub. 2000).

³¹ *Id.* at 197-198.

³² Ted Bergstrom, *Oligopoly*, University of California, Santa Barabara Department of Economics, slide 2 (visited Nov. 1, 2004) <<http://econ.ucsb.edu/~tedb/Courses/Ec100AF01/PPSlides/Ch27.ppt>>.

³³ *Id.* at slide 45.

³⁴ *Federal Trade Commission: Maintaining or Creating a Monopoly*, Free Advice (visited Nov. 3, 2004) <http://law.freeadvice.com/resources/gov_material/ftc_guide_to_antitrust_laws_monopoly.htm>.

³⁵ *Chapter 11*, Oswego State University of New York, Department of Economics (visited Nov. 3, 2004) <<http://www.oswego.edu/~economic/eco101/chap11/chap11.htm>>.

more firms involved with the competition, there is more freedom to act³⁶. There are an identifiable number of firms involved in the media industries and as a corollary, there is similar pricing; the price for a CD distributed by Sony tends to be similar to a CD released by Warner Music. Particularly, in the music industry, five firms control 80% of all titles produced in the U.S.³⁷ Based on this, there is a risk for both predatory pricing and collusion. While it may be difficult to identify collusion, the lobbying effort by the record industries for stiffer copyright protection seems to be a perfect example³⁸. This arguably collusive behavior is reflected in the treatment of the artists as well.

B. Fitting an Elephant through the Eye of a Needle

The balance between copyright holders and the media companies that distribute the works presents an undeniable dichotomy between creator's rights and big business. The Congressional Budget Office produced a report that appropriately cites the distinction as, "the ability of copyright holders and the industries that market and distribute creative products to find ways of applying those new technologies to generate sufficient returns to maintain the flow of new creative works."³⁹ However, the lobbying efforts by the media industry attempt to shift the view such that they are not media distributors or copyright holder representatives, but rather creators themselves. This is an important distinction because it clarifies the motivation of the media groups' efforts to lobby, litigate, and

³⁶ MCEACHERN, *supra* note 30, at 230-234.

³⁷ *Industry Brief: Music Recording I*, Oligopoly Watch (June 28, 2003) <<http://www.oligopolywatch.com/2003/06/28.html>>.

³⁸ LESSIG, *supra* note 24, at 248-268.

³⁹ *Copyright Issues in Digital Media*, Congressional Budget Office vii (Aug. 2004) (available at <<http://www.cbo.gov/ftpdocs/57xx/doc5738/08-09-Copyright.pdf>>).

generally enforce copyright related issues. The focus is not on preserving creative content, but rather protecting a product and revenue stream⁴⁰. Further, the media industries are having their livelihood threatened, not by the evils of digital media piracy, but rather technology that allows simplified methods of artist cultivation, promotion, and finished product distribution⁴¹. The industry's oligopoly is being challenged by new entrants because the major entry barriers have been removed⁴². Further, much to the dismay of the media industries, there has been a shift in the social norms that are driving the change.

C. What's Normal

The Dot-Com Era created a societal and cultural shift in the feeling toward and treatment of Internet based goods. As companies went live with electronic businesses and stepped away from traditional brick-and-mortar enterprises, corporate valuation was no longer based on debt, revenue, and sales, but rather clicks and unique visits⁴³; the more visitors, the higher a company's stock rose⁴⁴. In an effort to get unique views and click through users, the online enterprises established a unique pricing scheme to drive users to their electronic stores. The bottom-line price was often free and in many cases when a company attempted to charge for service, a competitor arose that undercut the pricing and

⁴⁰ *Music to Whose Ears?* University of California-Berkeley Boalt Hall School of Law Conference on the Debate over Digital Music 11 (April 6, 2000) (available at <<http://www.law.berkeley.edu/institutes/bclt/events/roundtable99/background.pdf>>).

⁴¹ *Id.*

⁴² *Id.* at 12.

⁴³ Jerry Useem, *Dot-coms What Have We Learned?*, *Fortune*, Oct. 30, 2000, at 82.

⁴⁴ Jack Wilson, *eBusiness: The Hope, the Hype, the Power, the Pain*, Univ. of Massachusetts (visited Nov. 3, 2004) <<http://www.jackwilson.com/eBusiness/eBusinessBook/Finances.htm>>.

competed by giving away the service⁴⁵. The Dot-Com Era pricing structures created the first push toward shifting the socially normal view of “access pricing” on the Internet, which was only echoed with the advent of peer-to-peer file sharing systems⁴⁶.

The rise of P2P file sharing technology and its widespread use only propagated the social norm we see persisting today⁴⁷. The media industries have used the litigation side of their strategy to fight this social norm and attempt to return some order to media content distribution⁴⁸. What is being overlooked by the media distributors is that this social norm is an intricate attitude that can be used to furnish new revenue streams. While some believe that, “so many people... knowingly violating the law is culturally unhealthy,⁴⁹” these attitudes simply reflect the desire for a market shift and a realignment of social norms. File sharing or digital content stealing cannot be classified as a “gateway” crime in the same way marijuana is considered a gateway drug; just because someone downloads the new Britney Spears song this week does not mean she will go rob a bank next week. Further, the social norms we are experiencing now in regard to copyrighted material are not much different from the past. Consumers do not pay for copyrighted material because it is copyright, but rather they pay for a quality product.

Quality of produced works and related marketing leads to consumer demand, not the fact that there is a legal right to the work. At one time, consumers dealt out hard

⁴⁵ Useem, *supra* note 43, at 82.

⁴⁶ LESSIG, *supra* note 24, at 125-126.

⁴⁷ *Id.*

⁴⁸ WILLIAM W. FISHER III, *PROMISES TO KEEP* 243 (Stanford Press 2004).

⁴⁹ *Id.*

earned dollars for a product called a Pet Rock, no more than an average stone in a box⁵⁰. There were plenty of free rocks outside, but consumers were drawn to this product, which resulted in revenue for the company producing the product. What can be learned from this? People will pay for anything and a company can charge a premium for the right to choose. You can have a dirty, unfriendly rock for free from the side of the road or a pleasant, well trained rock in a box for a premium. Further, when a consumer decided to pick-up a free rock from the side of the road, this did not mean he was stealing from the pet rock industry. He was exercising his freedom of choice in a free market economy. While the pet rock analogy is not a direct correlation to the media industries,⁵¹ the fact of the matter is when a free market coexists with a pay market, there must be some differentiating factor to drive consumers to pay for a product as opposed to taking it for free. From pet rocks to virtual companies, businesses over time, and namely the recent Dot-Com Era, taught us one other thing about access pricing, free is not a price that can exist in business equilibrium; companies must make enough money to continue their operations.

IV. Barriers Are Being Erected on all Fronts

While there is always the potential the media and content delivery companies will realign their models to better reflect one of a distribution company, barriers are being erected by lobby groups and Congress alike. Traditional media is acting in an effort to preserve the oligopoly, litigate social norms, and contain their “old guard” operations.

⁵⁰ *Pet Rock*, Super70s.com (visited Nov. 3, 2004)
<http://www.super70s.com/Super70s/Culture/Fads/Pet_Rocks.asp>.

⁵¹ There were countless unclaimed rocks in nature, when dealing with digital copies of copyrighted songs, there are countless copies available as well, however the copyright holder lays claim to those as too.

A. Preserve and Protect

Congress has taken the opportunity to realign the laws regarding copyright regulation and media distribution with guidance from major industry players. This guidance has resulted in regulations reflecting the need of the competitors and not necessarily the consumers or creators.

Mr. Lessig diligently outlines how the music and movie industries have used their power to influence Congress to extend copyright terms⁵². Lessig notes that, based on a net present value (NPV) analysis of a company's existing copyright, it is worth it for them to spend up to that NPV on lobbying efforts⁵³. There is a fatal flaw in this argument, though. This assumes that every company that owns a copyright will be able to lobby for, and succeed in, gaining a copyright extension based on their marginal contribution. It is a popular belief that the media companies or copyright owners have unlimited power to engage Congress to effect copyright extensions and manipulate the laws related to their regulation. However, a company itself does not necessarily have the power, so from where does this opinion arise? The answer is the power of collective bargaining.

In an oligopoly, non-associated companies may attempt to work together to form a cartel⁵⁴. When firms in a marketplace work together in collusive behavior to set prices, set quantities, and divide up the market, they have established an illegal cartel⁵⁵. Based on the media producers collective work via their respective trade groups (the RIAA and MPAA),

⁵² LESSIG, *supra* note 24, at 217-218.

⁵³ *Id.* at 216-217.

⁵⁴ DUNCAN K. FOLEY, ECONOMIC REASONING 179 (2004)
<<http://homepage.newschool.edu/~foleyd/GECO6190/>>.

⁵⁵ *Id.*

the media industries have created what echoes of a cartel⁵⁶. However these trade groups have avoided being classified or prosecuted as a cartel by a legal distinction between explicit and tacit collusion⁵⁷. Explicit collusion is punishable by law:

so that the act of communication is of central importance. For economists, however, this distinction has no meaning. In game theory models of collusion, the term "agreement" does not imply a formal communication - all that is needed is for the cartel members to have an "understanding" of how others will react to their behavior. Such shared beliefs - whether acquired tacitly or not - can support a self-enforcing, collusive equilibrium⁵⁸

This distinction has most likely lead to the lack of any form of antitrust action against the media companies; however, the distinction is irrelevant for an economic analysis. Further, the distinction also has not stopped media distributors from exerting their power to influence Congressional and market decisions. The most recent example of this is in the cable industry.

Consumer demand and technology accessibility has driven interest in what is aptly known as "A-La-Carte Pricing" in the cable and satellite industry⁵⁹. In A-La-Carte Pricing, cable subscribers are able to purchase and view only the channels in which they are interested, as opposed to being forced to purchase an entire cable package of channels⁶⁰. Cable and satellite companies have been reluctant to adopt a model of this sort claiming, "it would ultimately raise subscriber costs and harm diversity on the airwaves,"

⁵⁶ Dan Krimm, *Creating a Merit-Based Music Economy: Compulsory or Blanket Licensing for Interactive Subscription Services*, 19 (June 2003) (unpublished manuscript, on file with Hastings Law Journal).

⁵⁷ Anthony Maul, *Are the Major Labels Sandbagging Online Music? An Antitrust Analysis of Strategic Licensing Practices*, 7 N.Y.U. J. Legis. & Pub. Pol'y 365, 390 (2003).

⁵⁸ *Id.*

⁵⁹ Frank Ahrens, *FCC Asked To Examine A la Carte Cable TV*, Wash. Post, May 20, 2004, at E04.

⁶⁰ *Id.*

since popular channels subsidize less popular channels creating a diversity of viewing choices⁶¹. But how much more could cable rates rise? Cable prices have already risen three times the rate of inflation since market deregulation in 1996⁶². The cable companies claim an astronomical jump in hardware and technology upgrades are necessary to achieve A-La-Carte Pricing and the scheme would crush small and niche channels⁶³. As we see in the music and movie industries, the cable companies are misclassifying their industry's primary purpose.

It is not Comcast or Cox Communication's responsibility to support fledgling networks. Their job is to act as the means of delivery to end viewers. A-La-Carte Pricing would not create an all or nothing situation where consumers are forced to choose only the channels they want, but rather build in an additional option where consumers are permitted to choose higher priced, single-channel options. Further, one of the cornerstones of the cable industry's argument is that smaller, niche channels would be squashed eliminating the wide variety of choice exhibited in the current marketplace⁶⁴. The flip side to this argument is a lot of the small niche networks are actually in favor of A-La-Carte Pricing, but do not have the collective power to push their views through to Congress or the FCC⁶⁵. Further, the Consumers Union and the Consumer Federation of America estimates place the additional cost for A-La-Carte Pricing at an additional one to three dollars per month

⁶¹ *Id.*

⁶² Frank Ahrens, *Sorry -- No a la Carte Cable*, Wash. Post, March 26, 2004, at E01.

⁶³ Michael Grebb, *Cable a la Carte Still Half-Baked*, Wired News (Jul. 14, 2004) <<http://www.wired.com/news/politics/0,1283,64203,00.html>>.

⁶⁴ *Id.*

⁶⁵ *Id.*

per subscriber⁶⁶. But the push for A-La-Carte Pricing would substantially open the market to competition, which the cable companies do not want to happen. So again consumer demand is subdued, and the oligopoly is preserved for now.

Based on the cable argument, the music industry can argue that no individual songs should be sold because it is necessary for the good music on a CD to be purchased in conjunction with the less popular music to give consumers a greater diversity of options. This argument is flawed from a strategic prospective; for consumers it eliminates choice and for the music industry it eliminates the opportunity for additional revenue . It is a blinding task to visualize how consumers are being taken out of the marketplace and these oligopoly industries are given the freedom to grow and dominate, then complain to Uncle Sam when consumers' demand they have their power brought into check. So if you are in the media industry and you feel your power slipping away, what do you do? Sue everyone you can get your hands on.

B. Damage Done

The media industry lawsuits and lobbying initially seemed to have some success at redefining societal norms. However, the lawsuits have reached the point of diminishing marginal returns. The media industry as a whole, including television, music, and movies, made over \$29.6 million in lobbying expenditures in 1998 and contributed an additional \$16.4 million to political campaigns⁶⁷. Further, the RIAA itself spent \$820,000 and

⁶⁶ A-La-Carte Pricing computations performed by Consumers Union and the Consumer Federation of America can be found in Appendix B. Gene Kimmelman & Dr. Mark Cooper, *Reply Comments of Consumers Union and the Consumer Federation of America before the Federal Communication Commission*, at 2, (Aug. 13, 2004) (No. 04-027) (available at <<http://www.consumersunion.org/pub/0813%20CUCFA%20A%20la%20Carte%20FCC%20Reply.pdf>>).

\$244,260 in lobbying expenditures and donations to political campaigns, respectively⁶⁸. Further, the RIAA has spent over \$16.7 million on legal fees related to the prosecution of piracy⁶⁹. As a result of these efforts, the RIAA has managed to recover a whopping \$9.5 million in lost profits⁷⁰. Further, there are still 10.4 million households downloading music and, “the average number of files downloaded per household grew between April and June [of 2003], from 59 to 63.⁷¹” To add insult to injury, the most recent case to be tried against large-scale distributors resulted in a crushing blow to the music industry⁷². In *MGM Studios, Inc. v. Grokster Ltd.*, the court held in favor of Grokster and stated that:

if a defendant could show that its product was capable of substantial or commercially significant noninfringing uses, then constructive knowledge of the infringement could not be imputed. Rather, if substantial non-infringing use was shown, the copyright owner would be required to show that the defendant had reasonable knowledge of specific infringing files⁷³.

The reason this holding is damaging to the RIAA is the underlying rationale. Each file is considered in the singular so there must be instantaneous recognition of its illegality. The capstone for these issues is Napster, the first truly recognized and widely used peer-to-peer system, which was appraised at \$515 million at the time the music industry brought suit⁷⁴.

⁶⁷ Alfred C. Yen, *A Preliminary Economic Analysis of Napster: Internet Technology, Copyright Liability, and the Possibility of Coasean Bargaining*, 26 Dayton L. Rev. 247, 272 n.81 (2001).

⁶⁸ *Id.*

⁶⁹ Jon Newton, *Record Labels - More Powerful than the Police*, Industry News (Aug. 4, 2003) <<http://news.dmusic.com/article/7345>>.

⁷⁰ *Id.*

⁷¹ Roy Mark, *College File Swapping: Making the Illegal, Legal?*, InternetNews.com (Sept. 1, 2003) <<http://www.internetnews.com/ec-news/article.php/3071331>>.

⁷² *MGM Studios, Inc. v. Grokster Ltd.*, 380 F.3d 1154 (9th Cir., 2004).

⁷³ *Id.* at 1160-1161.

⁷⁴ 26 Dayton L. Rev. at 267.

For that price, the music industry would have gained access to all the users, network, and structure already in place⁷⁵. Instead they embarked on a path having little if no effect on adjusting social norms. And from a cost-benefit point of view, the music industry has spent nearly as much fighting a battle as it would have cost to technologically improve the industry. Finally, the industry fallout is not nearly as astronomical as prophesized by big media when aggregate economic factors are observed.

While most of the onus is placed squarely on the shoulders of music downloading as a source of the media industry's financial woes⁷⁶, there is one major economic factor that must be considered. The U.S. has been in a recession, which was sparked by the burst of the Dot-Com bubble⁷⁷. As is typical in a recession, when people have insecurity about their jobs and source of income, they decrease retail spending⁷⁸. The media companies are classified as retail goods and were bound to suffer some form of loss during a recession⁷⁹. Between 1999 and 2001, non-auto retail sales decreased almost 5% per year⁸⁰, which equates to approximately a 14.3% drop in consumer retail spending over the three year period. When compared to the estimated 16% drop in consumer CD purchased proposed

⁷⁵ If the RIAA or a related music consortium bought Napster, they would have had to contend with potential antitrust related issues.

⁷⁶ *Music Biz Blames Pirates*, CDRinfo (Aug. 28, 2002)
<<http://www.cdrinfo.com/Sections/News/Details.aspx?NewsId=6757>>.

⁷⁷ Larry Dignan, *Hooray, it's an Official Recession*, News.com (Nov. 28, 2001)
<http://news.com.com/Hooray,+it's+an+official+recession/2010-1071_3-281613.html>.

⁷⁸ Mark Gongloff, *When Will We Spend Again?*, CNN Money (Oct. 26, 2001)
<http://money.cnn.com/2001/10/26/economy/economy_consumer/>.

⁷⁹ See generally, *Retail Industry: Top 10 Issues 2004-2005*, Deloitte Consulting (2004)
<www.deloitte.com/dtt/cda/doc/content/US_CB_RetailTop10.pdf>.

⁸⁰ *Id.* at 3.

by the music industry⁸¹, the divergence in time of recession does not appear as detrimental as the industry makes it out to be. There is a 1.7% difference, between the economic depression and the music industry; however, this is well within a de minimus deviation for an economic analysis.

So, we are in a recession, the media industries are screaming bloody murder as to the societal treatment of their copyrights, but the foundation for their lost sales complaint is arguably unfounded. Further, the tide of lawsuit and lobbying actions has returned weak results. When push comes to shove, what is happening to those who are creating the content that drives the media industries success? Are we inappropriately defining our victims?

C. Using Copyright Laws to Increase the Stranglehold

Artists, musicians and all those who add to the creative foundation of our society are the ones who are suffering the byproducts of big media's actions to manipulate their respective industries to increase copyright protection. One of the foundations of creative content in society is the ability to compose and conduct new works based on deriving one's own work from past artists. Mr. Lessig prophesizes the death of this derivative use based on amplified statutory protection and increased copyright terms⁸². Lessig believes the changing scope of copyright laws have lead to the unprecedented control over current derivative uses⁸³. The question is how far away is this doomsday prophecy? The

⁸¹ Rafael Rob & Joel Waldfogel, *Piracy on the High C's: Music Downloading, Sales Displacement, and Social Welfare in a Sample of College Students* 1 (April 5, 2004) (National Bureau of Economic Relations Working Paper No. w10874) (available at <http://www.nber.org/papers/w10874>).

⁸² Molly Wood, *Web Innovation and Fair Use Bite the Dust*, CNet (Aug. 16, 2002) <http://reviews.cnet.com/4520-3513_7-5021236-1.html>.

additional limits on the future of creation protection are already in place and being locked down.

Big media companies have worked to increase their hold on all creative markets by increasing lobbying efforts. This concept is characterized in the increased restrictions imposed under the Digital Millennium Copyright Act (DMCA)⁸⁴, the No Electronic Theft (NET) Act⁸⁵ and Lessig's hotly contested Sonny Bono Copyright Term Extension Act (CTEA)⁸⁶. While much of this legislation is very recent, some of the potential effects on creativity in the U.S. have been seen as a threat to the balance between the aggregate creative content in society as well as a threat to the Constitutional framer's vision of copyright in of itself⁸⁷. All this protection is in response to the media companies, not the artists, response for help. Therefore, the positively forecasted results for copyright equilibrium presented are heavily contentious. While few outside the media industry contend this is the best course of action, we are left to see the outcome in a future release.

V. Structuring the Right to Buy

If social norms cannot be changed, they can be harnessed, but first they must be understood. Further, the industry and its applicable models must be considered before they can be implemented.

⁸³ LESSIG, *supra* note 24, at 136.

⁸⁴ *Id.* at 157.

⁸⁵ *Id.* at 215.

⁸⁶ *Id.*

⁸⁷ Graeme W. Austin, *Does the Copyright Clause Mandate Isolationism?*, 26 Colum. J.L. & Arts 17, 37 (2002).

A. We Will Pay for Our Freedoms, Thank You

The big media industries have overlooked a very major point as they have constructed their strategy; consumers will pay more for the freedom of choice. The new Napster music service is a prime example of paying a premium for access, delivery method, and format choice. On Napster, it costs users \$9.95 a month for a subscription to *rent* music tracks⁸⁸. If users wish to burn music to a CD to listen to it in a conventional CD player, they incur an additional \$0.99 fee per song, all of which contains restricted use⁸⁹. For comparison purposes, in 2003, the average price of a CD was \$15.06⁹⁰ and the average number of tracks on a rock CD was 13⁹¹. This means, the average cost per song on a rock CD was \$1.16⁹². While this price may appear to justify a \$0.99 price per song on Napster, consider the following information. With over three million paying users on Napster, in order to get the same price as the average \$1.16 per song on CD, based on the \$9.95 monthly subscription fee, a user would have to download more than 62 songs per month⁹³. Based on the royalties paid to the music industry, there is no doubt they would be happy

⁸⁸ *What is Napster?*, Napster Website (visited Nov. 5, 2004)
<http://www.napster.com/what_is_napster.html>.

⁸⁹ *Id.*

⁹⁰ *2003 Yearend Statistics*, Recording Industry Association of America (2004)
<<http://www.riaa.com/news/newsletter/pdf/2003yearEnd.pdf>>.

⁹¹ *Average Number of Tracks by CD for each Genre*, IT Innovations and Concepts (visited Nov. 5, 2004)
<<http://www.itic.ca/DIC/music/2003/09/avg-content-cd-tracks.jpg>>.

⁹² Computed as [\$15.06 per CD] divided by [13 songs per CD].

⁹³ Computed as [\$9.95 monthly fee] divided by [\$1.16 – \$0.99 as the difference between CD and Napster per song fees].

Napster does, “not disclose any information regarding the purchasing habits of our members,” therefore an exact estimate of the number of songs downloaded per user, per month cannot be cited. Email response from Dana Harris, Director of Napster Corporate Communications, in Los Angeles, CA (Nov. 16, 2004).

with these results. These astronomical numbers are not being reached on a monthly basis and users are paying, on average, more per song in order to have the freedom to choose single tracks⁹⁴.

B. Miss the Boat and You May Fall Off the Face of the Earth

A traditional method of conducting an external environmental analysis is known as a SWOT analysis where a firm or industry dynamically examines the Strengths, Weaknesses, Opportunities and Threats based on a proposed action⁹⁵. A firm's strengths are those resources and capabilities that are valuable, rare, costly to imitate, and sustainable⁹⁶. In the case of the music industry, the copyrights themselves do not necessarily fit the facet of being a sustainable competitive advantage, at least not in the long run. While the copyrights are valuable and sustainable based on current federal regulation, technology has reduced their ability to be imitated.

A strategic weakness in the industry is the ability to control social norms. While the industry is convinced they can do so, as stated before, the legal approach is having marginal returns at best⁹⁷. Further, the opportunities and threats come from an environmental analysis of how a specified approach effects the corresponding environments; namely the socio-cultural, economic, technological, and political/legal environments⁹⁸. For example, when the media industries chose to embark on a route of

⁹⁴ *Id.*

⁹⁵ MICHAEL HITT ET AL., *supra* note 27, at 52-59.

⁹⁶ *Id.* at 84-88.

⁹⁷ *See generally*, Part IV., Section B titled *Damage Done*, of this paper.

⁹⁸ MICHAEL HITT ET AL., *supra* note 27, at 44-52.

lobbying and lawsuits, it appeared to be a logical maneuver to attack those “stealing” from the industry. However, the media industries failed to observe a dynamic analysis of the corresponding environments. Taking a critical approach to this, as the industries manipulated the legal/political environment, society’s values and attitudes (social norms) were already in a state of transition. Further, technology had advanced beyond what the industries could control and their actions had little success at stopping the technological dissemination⁹⁹. Acting on miscalculations or misclassifications has crippled the media industries on a grand scale. Similar results can be observed in other industries based on a failure to properly apply a strategic analysis to their actions.

Misclassification of a company’s goal and directives will lead to a loss of revenue and failure to grow and progress in the appropriate direction¹⁰⁰. The misclassification and failure to appropriately forecast the repercussions from an action can also result in an unwanted regulatory scheme¹⁰¹. This has come to light in the current case of radio and television regulation by the Federal Communication Commission (FCC) which drove pop-culture radio icon Howard Stern from the free airwaves to satellite broadcasting¹⁰².

Many believe radio companies like Clear Channel have a stranglehold on the radio market. Companies of this stature have no incentive to influence the government’s regulatory regime over their broadcast medium when there is no alternative. But, again, this is a case of a company being blindsided by the advent and acceptance of technological

⁹⁹ See generally, Part IV., Section B titled *Damage Done*, of this paper.

¹⁰⁰ MICHAEL HITT ET AL., *supra* note 27, at 83.

¹⁰¹ Interview with William Spaulding, Lecturer of Management, Wayne State University School of Business Administration, in Detroit, MI (May 31, 2004).

¹⁰² *Shockjock Stern to Go Satellite*, CBS/AP News (Oct. 6, 2004) <<http://election.cbsnews.com/stories/2004/04/16/entertainment/main612355.shtml>>.

advancements¹⁰³. In the past few years, consumers have encountered a new means of receiving radio broadcasts, satellite radio¹⁰⁴. With this new medium, consumers, once again, are given the opportunity to pay a premium for the freedom of choice¹⁰⁵. Not only are consumers opting to pay, but they are moving in masses to the new medium¹⁰⁶. While market forces in of themselves have sparked much of this move, one of the key factors is the overregulation in traditional radio by the FCC¹⁰⁷. This heightened level of fines and regulation have pushed traditional radio advocates to leave the free airwaves and enter the pay marketplace¹⁰⁸. As a byproduct for the traditional radio broadcasters who have not worked to properly influence FCC regulation, the result has been a loss of market share and revenues¹⁰⁹. While this is one example of an industry being hit by the failure to properly assess their business position from a legal and regulatory standpoint, the failure to analyze one's business purpose can have similar results.

A strong example of improper business analysis can be observed in the case of Eastman Kodak. Focusing on its ability to produce high end prints from photographic film, Kodak, for years, regarded itself as a picture company¹¹⁰. However, Kodak was

¹⁰³ *Shock Jocks Boost Satellite Radio Profile*, Associated Press (Oct. 19, 2004)
<<http://www.forbes.com/associatedpress/feeds/ap/2004/10/09/ap1584222.html>>.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Sirius Subscriptions Up After Stern Deal*, Associated Press (Oct. 19, 2004)
<<http://www.forbes.com/associatedpress/feeds/ap/2004/10/19/ap1597402.html>>.

¹⁰⁷ *Shock Jocks Boost Satellite Radio Profile*, *supra* note 103.

¹⁰⁸ *Id.*

¹⁰⁹ *Viacom Posts Loss on Blockbuster Charge*, Associated Press (Oct. 28, 2004)
<<http://www.forbes.com/associatedpress/feeds/ap/2004/10/28/ap1617035.html>>.

crippled by lost revenue with the advent of digital imaging¹¹¹. As the price of digital cameras dropped, more people were introduced to digital technology and fewer people paid to expose traditional prints. Instead, people transitioned and began storing them in digital form on their computers. It was not until Kodak reverted to a model of an imaging company that they were able to recover market share¹¹². By viewing themselves as an imaging company and focusing on the images associated with any camera, digital or film, Kodak appropriately moved to a structure focused on customer demand and an evolving marketplace.

VI. Don't Look the Other Way, Act a Different Way

Traditional media is a dying industry. Traditional television, movie and music companies need to continually work harder to maintain their present position¹¹³. Further, two primary indicators of a dying goliath are a consolidation or excess industry mergers in conjunction with extensive lobbying in Washington¹¹⁴. The media companies are pushing both of these aspects at an exceptional rate¹¹⁵ and must consider a new approach in order to survive. The new model must strike a balance between fair use for innovation and protection of copyrights. This requires a complete reassessment from the media industries.

¹¹⁰ Laura Rich, *Case Study: Eastman Kodak Co.*, CIO Insight (June 1, 2004) <<http://www.cioinsight.com/article2/0,1397,1610188,00.asp>>.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Interview with Bruce Lynskey, Clinical Professor of Management, Vanderbilt University Owen Graduate School of Management, in Nashville, TN (Nov. 16, 2004).

¹¹⁴ *Id.*

¹¹⁵ *Id.*

Copyright law should be seen as protecting public interest, not just individual creators¹¹⁶. This view will permit the copyright framework to diverge from a monetary focus and target influencing creativity¹¹⁷. Further, the adoption of the view that copyright law is there purely to protect the copyright holder has lead to the oligopoly we currently have.

Competition is coming and media companies have the ability to grab a lion's share of the new markets by utilizing the first mover advantage in the future. Inefficient oligopoly structures cannot be maintained in a free market economy such as the U.S. because competitors will move in to fill the void in niche markets and attempt to grow using their specific competitive advantages¹¹⁸. Social norms indicate people pay for choice and quality¹¹⁹ and legal barriers are just another hurdle, not a wall to consumer demand.

A. The Basic Framework

The media companies need to look at themselves as logistics companies. Based on an environmental analysis of the strengths, weaknesses, opportunities, and threats in the media industry, the copyrights are no longer a strategic advantage however, the marketing and distribution network the media companies have at their disposal can provide an advantage. The media industries strengths are not the product, but rather your ability to get product to market. The problem is not production. Technology has lowered these costs to make them more accessible to all artists and media companies alike, but getting the

¹¹⁶ Jeremy Paul Sirota, *Analog to Digital: Harnessing Peer Computing*, 55 Hastings L.J. 759, 780-781 (Feb. 2004).

¹¹⁷ *Id.*

¹¹⁸ Interview with William Spaulding, Lecturer of Management, Wayne State University School of Business Administration, in Detroit, MI (July 19, 2004).

¹¹⁹ See generally, Part V., Section A, titled *We Will Pay for Our Freedoms, Thank You*, of this paper.

product to the public is still difficult¹²⁰. While anyone can develop an idea, song, movie concept or show, marketing and distribution is the true barrier to which the media industries can grant access. This competitive advantage must be utilized to survive.

The copyright holders will benefit from this shift. They will have the ability to hire the best distribution company for their product, not necessarily those who have locked them into long-term contracts and hold them captive. The media companies will resist this aspect because they already have a captive artist base. However, a shift from the current, vertically integrated market scheme is necessary to eliminate the history-dependant path in the industries. While the old method was feasible, the competitive landscape has changed and is no longer being optimized.

As a logistics company, there are numerous constituents to be served. There are artists who need their product picked up and end users (consumers) who will receive the product in multiple formats. Neither can be ignored because both are necessary for the model to operate properly. Further, efficiency and time-critical delivery are necessary elements. Therefore, there must be a focus on technology advancements for security and infrastructure. With this model, the option to have the traditional method coexist is not dead, but the primary focus shifts to a more profitable method of operation. This is much more related diversification than traditionally done in media, but will provide for a better ability to refine and focus on true competitive advantages and core competencies. Further, based on consumer desire to pay more for the right to choose between delivery methods, the more novel the media industries can be, and the greater the premium they can charge for their product.

¹²⁰ *Cost of a CD*, Recording Industry Association of America (visited Dec. 15, 2004) <<http://www.riaa.com/news/marketingdata/cost.asp>>.

B. Protecting the Creators

Consumers will pay for choice and quality and this norm must be optimized. This is not to say those who create what society considers “good works” deserve more protection than those creative pieces not considered as high quality. However, it is not exclusively the job of the media industries to perpetually use lobbying power to extend copyright law. The focus for protecting the copyright holders from the point of view of the media companies needs to be in security protocols and systems integration. As exhibited with the software industry, companies need to work within the bounds of the technology available, not work against it¹²¹.

C. Technology Strategies

Some advocates contend there is no reason to invest in new technologies and digital distribution methods because they will simply become outdated and be cheaper to implement in the future¹²². While this argument has some merit, the onus is on distribution and security companies to address the financial issues inherent in their operations. Further, there are multiple strategies involved in technology integration including a first mover strategy, second mover strategy as well as a late adopter strategy, each with relative advantages and disadvantage¹²³. Based on the differences, one cannot argue that not adopting or constantly taking a “wait-and-see” approach is *always* right simply because technology will inevitably decrease in cost over time; that guarantees no change and

¹²¹ See generally, Part II, titled *Content Distribution and Piracy Battle Plans*, of this paper.

¹²² LESSIG, *supra* note 24, at 166.

¹²³ MICHAEL HITT ET AL., *supra* note 27, at 149-150.

promises death¹²⁴. The media industries have held to a history-dependent path as exemplified by the repetition of legal and lobbying actions each time there is a new technological jump¹²⁵. While copying what the competition does will provide flexibility of resources, some competitive aspects will be lost¹²⁶. Certain companies, such as Sony Corporation have made their niche with a first mover advantage by introducing and perfecting technological advances before the relative competition¹²⁷, while others such as Hitachi have exercised a follower strategy in order to optimize the late adopters market¹²⁸. Empirical data shows different competitors within different industries reap benefits from either the first or second mover strategies¹²⁹. However, this same data also points a company in the direction of a first mover strategy or a hybrid strategy when there is a need to focus on technological advancements and research and development in order to maximize returns¹³⁰. The technology adoption strategy for content distribution within the media industries needs to be considered based on the same grounds. A hybrid strategy employed by in-house development to more effectively and efficiently deploy resources will perpetuate a goal of meeting consumer demand as it evolves over time. In addition, it

¹²⁴ Han T.J. Smit & Lenos Trigeorgis, *Quantifying the Strategic Option Value of Technology Investments*, Real Options - Theory Meets Practice 8th Annual International Conference, at 4 (June 2004) (available at <<http://www.realoptions.org/papers2004/SmitTrigeorgisAMR.pdf>>).

¹²⁵ *20th Anniversary of Betamax: the Court Case that Brought You the VCR*, *supra* note 9.

¹²⁶ *Id.*

¹²⁷ Charla Griffy-Brown, *Small Firms Keep R&D Vibrant: Stay Competitive Despite Limited Resources*, Pepperdine University (2000) <http://gbr.pepperdine.edu/021/print_r&d.html>.

¹²⁸ *Id.*

¹²⁹ Smit & Trigeorgis, *supra* note 124, at 3-7.

¹³⁰ *Id.*

secures an evolutionary growth strategy for big media. This cannot be a static strategy, but one continually providing more differentiation for consumer and creator alike.

D. Structural and Supply Chain Integration

Media companies need to shift focus away from their current vertically integrated structure. The media companies have a strategy of both forward and backward integration to control the entire supply chain. Vertical integration is defined as the degree to which a company owns its upstream and downstream supply chain¹³¹. This has resulted in multiple inefficiencies based on a lack of competition from suppliers and higher overall operating costs¹³². These costs have perpetually been passed onto the consumer and made the end product pass beyond the threshold of equilibrium price based on relative differentiation¹³³. Within the media industries, the largest example of the failure of the vertical integration scheme is the merger of AOL and Time-Warner in 2000¹³⁴. This merger was supposed to add efficiencies and lower industry costs, but resulted in such a failure that over \$160 billion in market value was destroyed based on the inability to optimize supply chain synergies¹³⁵. Further, when competition can easily be obliterated based on game theory and collusion, there is no incentive for the oligopoly members to operate efficiently.¹³⁶

¹³¹ *Strategic Management*, Quick MBA (visited Nov. 12, 2004) <<http://www.quickmba.com/strategy/vertical-integration/>>.

¹³² Kevin Maney, *The strategy: Pack Distribution and Content into Powerhouse Combo*, USA Today Online (Feb. 16, 2004) <http://www.usatoday.com/money/media/2004-02-16-comcast_x.htm>.

¹³³ MCEACHERN, *supra* note 30, at 56-63.

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ Christopher S. Yoo, *Vertical Integration and Media Regulation in the New Economy*, 19 *Yale J. on Reg.* 171, 296 (2002).

This has been perpetuated by vertical integration. Wall Street knows this based on AOL-Time Warner; the consumers know this based on exercising alternative options; but the media industries seem blind to the fact. The media industries must consider a process of decentralizing operations to maximize competitive efficiencies. Again, this change will not be welcomed because it threatens the oligopoly, but it is necessary to lower costs, meet demand, and revive the industry.

E. Disputes Will Arise

As in the software industry, when there is a focus on digital media distribution, piracy is inevitable. Whether the piracy is willful or accidental, someone will find a way not only to usurp the system and security, but distribute the result. This, in and of itself, is not a reason to avoid entering a market or upgrading one's distribution network. It is, however, reason enough to consider how these claims will be handled. The current method has been a wide-scale legal assault on distributors and users in the courtroom with marginal results at best¹³⁷. Forcing a party to settle because they are unaware of their legal rights or unable to afford adequate counsel¹³⁸ does not solve the underlying problem of protecting the copyright holders while educating the public¹³⁹. The media industries need to consider an alternative dispute resolution (ADR) model in order to streamline the process for all parties.

¹³⁷ See generally, Part IV., Section B titled *Damage Done*, of this paper.

¹³⁸ LESSIG, *supra* note 24, at 200.

¹³⁹ Steve Marks, *General Counsel, Recording Industry Association of America, Florida Atlantic University*, Recording Industry Association of America (April 15, 2004) <<http://www.riaa.com/news/newsletter/041504.asp>>.

An ADR model will provide a number of unrealized benefits. In general, the mediation process was instituted and expanded because it reduces many of the risks associated with comparable litigation regarding both tangible and intangible costs¹⁴⁰. Tangible costs include the dollar value placed on litigation in court fees and legal fees; intangible costs include those related to lost productivity and emotional strain on the parties themselves¹⁴¹. Admittedly, there are relative risks in ADR including lower average settlements¹⁴², but as the situation currently stands, the average consumer case settles for approximately \$3,000¹⁴³. Further, the aggregate risks of ADR tend to be outweighed by the benefits in a copyright suit¹⁴⁴. If the media industries wish to hold true to their principles such that legal action is necessary in order to protect the artists¹⁴⁵, then an alternative dispute method will better protect the parties involved¹⁴⁶. Claims are settled in a timely manner, the costs are lower for all parties, and judicial economy is maximized.

F. Show Me the Money

The question should not be can this model make money, but rather how long can the media distributors act as the old guard before the entire industry implodes. The signs

¹⁴⁰ Kevin M. Lemley, *I'll Make Him an Offer He Can't Refuse: A Proposed Model for Alternative Dispute Resolution in Intellectual Property Disputes*, 37 Akron L. Rev. 287, 312-313 (2004).

¹⁴¹ *Id.* at 313-314.

¹⁴² *Id.*

¹⁴³ Paul Roberts, *RIAA Sues 532 'John Does'*, IDG News Service (Jan. 21, 2004) <<http://www.pcworld.com/news/article/0,aid,114387,00.asp>>.

¹⁴⁴ Lemley, *supra* note 140, at 315-317.

¹⁴⁵ Marks, *supra* note 139.

¹⁴⁶ 37 Akron L. Rev. at 326.

are there, what can be classified as “old media” companies are falling into a perilous situation. New competitors are setting up distribution channels that will allow copyrighted artists to reach the masses with their work in a manner that will not require current distribution channels¹⁴⁷. Unfortunately, the media companies have allowed their size and bureaucracy to place them in a position many other oligopoly industries have found themselves, fighting for minute pieces of market share while relatively small competitors begin to dominate the marketplace. As observed in the U.S. automotive industry, long thought to be one of the strongest oligopolies, the lack of concentration on entering competitors has resulted in foreign companies taking advantage of system efficiencies and changes in governmental regulation¹⁴⁸ to bring down the oligopoly¹⁴⁹. The software industry presents another example of industry monoliths reconsidering their strategies and producing a positive outcome.

There is no question that a select number of competitors dominate the software industry. Companies like Microsoft, Oracle, Dell, and IBM to name a few¹⁵⁰, command their respective niche in the same manner companies like MGM, Sony, and Viacom dominate in the media industries¹⁵¹. However, new entrants and technologies provide a

¹⁴⁷ Eric Butterfield, *Record and Promote Your Own Music*, PC World Online (Sept. 28, 2004) <<http://www.pcworld.com/news/article/0,aid,117926,00.asp>>.

¹⁴⁸ Kerry A. Chase, *Economies of Scale, Domestic Politics, and Trade Conflict* at 26-27 (1999) (Tufts University Department of Political Science) (available at <http://ase.tufts.edu/polsci/faculty/chase/economies.pdf>).

¹⁴⁹ Toyota, a Japanese manufacturer, is targeting a global market share of 15 percent by the end of the decade, putting it ahead of the current U.S. auto leader, General Motors and further dominating the U.S. automotive oligopoly known as The Big Three (Ford, GM, and Daimler-Chrysler). MICHELINE MAYNARD, *THE END OF DETROIT* 15 (Paperback ed., Doubleday 2004).

¹⁵⁰ Wylie Wong, *Software Giants Unite for Web Services*, CNET News.com (Feb. 5, 2002) <http://news.zdnet.com/2100-1009_22-830090.html>.

¹⁵¹ *Industry Brief: Music Recording 1*, *supra* note 37.

constant threat to the software giants' respective market share. Most recently and continually is the attack by open-source operating system Linux on Microsoft Windows¹⁵². However, even with the assault from pirates and competitors alike, the software giants are able to prevail through a multi-tiered approach including legal, legislative, and competitive reassessment. None of these factors alone are enough to retain a lead in the industry, however, in the aggregate, they are able to survive, grow, and thrive. Not by underestimating and neglecting the customer and the competitor, but rather working within the respective bounds to achieve optimal results.

Conclusion

Neither technology nor pirates are the source of all evil. In this day and age, they are two factors to be worked with and dealt with, but not disregarded. An industry cannot ignore these external environmental factors when designing its strategy and a failure to recognize this will result in a failure to grow. Sustained growth is not an accidental endeavor; it must be planned for and executed in a systematic manner to achieve optimal results¹⁵³.

In recent years, technology advancements and the accessibility to means of information reception have greatly reduced the cost to consumers and digital media content providers. However, along with these advancements have been a number of byproducts associated with the territory. These factors include the need for enhanced security, a

¹⁵² "Linux garnered a 27% share of operating-system software for computer servers sold last year, up from 24% in 1999 and 17% in 1998, according to market-researcher International Data Corp." *Linux Gains Market Share, Respectability*, Librenix – Information for Linux System Administrators ¶ 1 (last updated June 27, 2003) <<http://librenix.com/?inode=784>>.

¹⁵³ Interview with Bruce Lynskey, Clinical Professor of Management, Vanderbilt University Owen Graduate School of Management, in Nashville, TN (Oct. 21, 2004).

reevaluation of the current operating environment, and a reassessment of consumer demand for media in multiple formats.

The media industries have become apathetic over the years. The major threat to their existence is not piracy or peer-to-peer file sharing, but rather the reduced barriers to entry resulting in new competitors, threatening the very existence of the oligopoly or cartel the media companies have worked so hard to build up and barricade from the rest of business. No oligopoly likes being threatened, however if the collusion continues, the competition will find breaks in the dam to exploit. The fact of the matter is the old media model is representative of a dying industry gasping for air as it clings to market share and overregulation. However, this is only prolonging the death.

The media companies have lost focus. They push for stiffer copyright laws, longer periods of enforcement, and additional statutory coverage, but this strategy is not helping to expand the aggregate creative content in society. The artists, the parties who truly deserve the copyrights are being left out of the equation. The media industries are not gaining the results the artists deserve through their legal assault on pirates alone.

Technology has not been the only change; social norms have evolved since the Dot-Com Era. For better or worse, consumers care less about the legal implications of their actions and more about the quality of the product they are buying. A failure to recognize the benefit of consumers' desire to pay for their freedom of choice is a failure to recognize a market niche that can easily be exploited and has been exploited by companies such as Napster and Apple.

The continued governmental lobbying to eliminate any inkling of a revolt amongst consumers must be curtailed. The media industries are failing to look at the long-term

implications of their increased regulation. They will drive consumers to new media; this is best exemplified by the FCC's recent overregulation driving radio personalities and consumers to pay for satellite radio.

If the media companies are truly interested in cultivating and helping artists, they need to start acting like it; rhetoric will only get a company so far. The media industries have seen other industries like software fight through their battle with digital distribution, which has resulted in decreased piracy. The media industries must make a dynamic, strategic reevaluation of their respective industries and focus on their true strengths, namely their distribution and marketing machines. Further, they need to reassess their supply chain management and vertical integration plans to create as much efficiency in the system as possible. This will reduce product price and decrease time to market while capitalizing on social norms.

Finally, the media industries need to reconsider their legal approach. Piracy will always exist and while lawsuits may be optimal for large scale distributors, they do little to equitably resolve individual disputes. They also do not fulfill the media industries desire to "educate" the public that piracy is bad. An alternative dispute resolution process will not only streamline claims, they have the potential to maximize the return on investment into an ADR system.

No one ever said managing an industry was easy. The external economic factors that exist in business have come down in a crushing manner around the media companies. By reevaluating their operating structure and consumer demand the media distributors can come out on top and continue to perpetuate; it has been done before. Continuing to drive in the current direction will not lead to any form of Fountain of Youth for preservation, but

rather result in the same fate as the Fountain's other seekers, nothing more than an untimely demise.

Appendix A – DVD Growth 1998-2003¹⁵⁴

Year	Sell-Through DVDs (In Millions of Units)	Percent Change from Prior Year
1998	32.7	---
1999	91.3	35.82%
2000	174.4	52.35%
2001	350.0	49.83%
2002	650.6	53.80%
2003	985.3	66.03%

¹⁵⁴ *U.S. Entertainment Industry: 2003 MPA Market Statistics*, Motion Picture Association Worldwide Market Research, at 30 (2003).

Appendix B – A-La-Carte Pricing in a Mixed Bundle Environment¹⁵⁵

Network Type	Subscribers		Bundled		Monthly A-La-Carte fee needed to replace lost network revenue				Subscriber price
	Bundled	Mixed bundled	Revenue per month	Ad revenue per month	Subscriber	Ad	Marketing	Total	
	(000,000)	(000,000)							(with cable mark-up)
General	87	70	\$0.67	\$0.48	\$1.12	\$0.11	\$0.38	\$1.61	\$2.72
News	86	60	\$0.20	\$0.20	\$0.50	\$0.10	\$0.16	\$0.76	\$1.28
Older	80	52	\$0.18	\$0.12	\$0.60	\$0.09	\$0.20	\$0.89	\$1.50
Younger	84	63	\$0.25	\$0.24	\$0.50	\$0.08	\$0.20	\$0.78	\$1.32
E. Niche	34	20	\$0.09	\$0.06	\$0.45	\$0.07	\$0.15	\$0.67	\$1.13
E. Mass	64	38	\$0.08	\$0.09	\$0.40	\$0.12	\$0.17	\$0.69	\$1.16

Definitions:

- **General** – mainstream networks such as ESPN, Lifetime, USA and Nickelodeon
- **News** – news networks such as ABC, CNN, and Fox News
- **Older** – older trending networks such as A&E and Bravo
- **Younger** – younger trending networks such as Disney, Comedy Central and MTV
- **E. Niche** – emerging niche networks such as Oxygen, BET Jazz, and Soapnet
- **E. Mass** – emerging mass market networks such as The Family Channel, SciFi and Court TV

¹⁵⁵ Kimmelman & Cooper, *supra* note 66, at 53.