September 28, 2005

Dear Chairman Specter and Ranking Member Leahy:

Thank you for holding this important and timely hearing on protecting copyright and innovation in a "Post-*Grokster*" world. I greatly appreciate your leadership and that of your Judiciary Committee colleagues. We appreciate the opportunity to share eDonkey's perspective on this critical industry and consumer issue.

## I. Preface

My name is Sam Yagan. I currently serve as President of MetaMachine, Inc., developer and distributor of the industry-leading peer-to-peer (P2P) file-sharing software application called eDonkey.

Prior to joining MetaMachine, I co-founded and served as CEO of the educational publishing company SparkNotes, which Barnes & Noble, Inc. acquired and now owns. I hold a Bachelors Degree in Applied Mathematics from Harvard University and an MBA from Stanford University. My wife and I live in Cambridge, Massachusetts.

I would like to preface my remarks with a few comments about my presence before this committee: I have no specific agenda to advance. I am not a P2P zealot. I generally turn down speaking engagements other than those directly supporting the development of solutions to the ongoing conflicts between content rights holders and technology developers. I accepted your invitation because I hope that my deep commitment to making peace with the entertainment industry, which I have already communicated to the RIAA, will allow us to engage in a productive, forward-looking dialogue without rehashing our past differences.

I have made public addresses just twice before today: at the Cato Institute conference on "The Law and Economics of File Sharing" in June 2004 and at the U.S. Federal Trade Commission "P2P Workshop" in December 2004. I accepted those speaking invitations, as I accepted yours, because they provided an opportunity to advocate for practical market-based solutions to the problems facing rights holders and technologists. To be clear: I am not testifying for personal publicity or to promote eDonkey; rather I appear before you out of a sense of obligation – a sincere hope that my experiences can help move this discussion forward.

I hold no animosity toward entertainment industry executives or others who have opposed the advancement of P2P technologies over the last few years. Even those of us within the file-sharing industry have struggled to understand these constantly evolving technologies and how they impact other industries. However, given my relatively unique vantage point on the cutting edge of technological development, I have grave concerns about whether the rewards of entrepreneurship in the future will outweigh the substantial risks associated with developing innovative new technologies. Perhaps the most important message I hope to communicate stems from my passion for entrepreneurship – please, try to empathize with a young entrepreneur trying to innovate in a nascent industry. I hope you will do all that you can to nurture and encourage that entrepreneur and provide her an environment in which she can face the myriad challenges that startups do without the additional burden of having to wonder how a judge many years in the future will construe her every thought, email, and business plan.

## II. Background on MetaMachine, Inc., eDonkey, and Overnet

The names can get a bit confusing, so let me clarify the various names associated with our business. We conduct business under our corporate name, MetaMachine, Inc. We distribute our file-sharing software under the brand name "eDonkey" (formerly known as "eDonkey2000"). This highly advanced file-sharing application functions as a completely distributed, self-organizing P2P software client and supports redistribution of all file types running on Windows, Mac OS X, and Linux. The name "Overnet" describes the underlying communication protocol that eDonkey clients, or personal computer (PC) software programs, use to search other clients and find files for downloading. Thus "Overnet" functions similarly to "FastTrack" or "Gnutella."

MetaMachine, Inc., a New York corporation founded in 2001 develops and distributes eDonkey, which many research studies cite has having a larger user base than any other P2P application. We incorporated MetaMachine in the United States because we believed at the time, as we continue to believe to this day, that software development was, is, and should be a legal, respected, and encouraged activity in the United States.

We have succeeded in developing an innovative technology and a global user base. By incorporating in the U.S., we agreed to abide by the laws of this great nation and have generally made ourselves available to government agencies, the press, and most importantly, the entertainment industry. Unlike some of my colleagues, I have reached out to the major labels and studios in hopes of finding partners to collaborate in developing an innovative new channel for licensed distribution of music and video content.

In fact, seven of the top ten major P2P software companies have chosen to locate outside of the U.S. We must all keep this geographical issue in mind when assessing the practical benefits of any proposed legislation. First, we must consider if the legislation will affect entities outside U.S. jurisdiction; second, we must consider the possible costs of pushing technology entrepreneurs offshore.

I hope America can continue to support innovation, both creative and technological, based on the free-market drivers of capitalism rather than attempting to control and guide technological innovation in a centralized manner that may unintentionally drive innovation underground and offshore.

## III. Outreach: Our Good Faith Effort

I have spent an immense amount of energy trying to acquire licensed content from the major rights holders. As noted in my preface, I also spoke at the June 2004 Cato Institute conference on file sharing and provided testimony at the December 2004 Federal Trade Commission (FTC) Workshop on P2P in support of licensing content for authorized P2P distribution. In my comments at both of these events I pleaded with content owners to engage with us in productive dialogue.

Our company also participated with nine other companies in the Distributed Computing Industry Association's (DCIA) P2P Revenue Engine (P2PRE) project, which focused on providing a robust solution for major entertainment content rights holders to securely market their copyrighted works via a P2P distribution channel. Although we had no way of knowing whether the P2PRE would work, we embraced the opportunity to experiment with a receptive partner in the entertainment industry.

For that project, we developed technical plans and business models, not only to secure and monetize licensed content entered into P2P distribution by rights holders or their authorized agents, but also to address their greatest concern: the redistribution of unlicensed content that has been entered into the P2P environment from unprotected CDs and DVDs directly by consumers. The P2PRE project held multiple meetings with major music labels and publishers as well as movie studios, and at one point, received verbal commitments from major entertainment firms to proceed with proof-of-concept technical testing and market trials.

The firms later rescinded these approvals, however, with the private explanation that to proceed in collaboration with eDonkey on a business solution, or even to appear to be doing so, could jeopardize the case of the petitioners in the pending *MGM v. Grokster* litigation.

I also reached out to major labels outside of the context of the DCIA's P2PRE. eDonkey sought to enter into constructive negotiations with major labels and studios to license content for distribution by means of innovative P2P business models. I had lengthy conversations with two major music labels and came close to striking a deal with one of them. Our negotiations ended when they required me to do things with the eDonkey application that I simply could not do technologically, ethically, or without taking on even more legal exposure.

I should note that we participated in all of the above talks against the advice of our counsel who urged us not to engage in such dialogue out of fear that comments I would make at these meetings might hurt our case in any future litigation.

In the meantime, however, we began to license audio and video content from small, progressive, independent rights holders directly and through innovative new companies that have begun to emerge, such as INTENT MediaWorks, Shared Media Licensing, and Altnet.

I can point to two successful campaigns that we ran directly with artists. In one case, we worked with Rock and Roll Hall of Famer Steve Winwood to promote the release of his new album *About Time*. We promoted a video of Mr. Winwood performing the song at a live venue as well as a video of him recording the track in his studio. We also worked with a band called Bishop Allen, which we promoted very heavily in the eDonkey

application, contributing to its sales of tens of thousands of CDs as well as its brief appearance on Amazon's top ten in sales.

As a graduate student at Stanford University, I conducted a study on possible new business models for the music industry given the advent of file sharing and in particular looked at independent bands and their use of P2P as a distribution mechanism. Without exception, every independent band I interviewed begged for increased distribution – gladly willing to distribute promotional music for free in the hopes of gaining fans and widespread popularity. In fact, after file-sharing, the technique most cited by independent bands for acquiring fans was taping signs to lampposts. I find it difficult to refute the fact that many independent bands thrive on the distribution offered by P2P application, even in its current "open" form.

## IV. Our Mission

eDonkey's mission has always been to create cutting-edge technology for the distribution and storage of digital content. We foresaw numerous legitimate uses including distribution of content by rights holders and redundant data storage for corporate and individual users. For example, we held extensive conversations with one radio producer who wished to link to archived versions of his radio show. Rather than shoulder the distribution costs himself, we wanted to link directly to a file resident in an eDonkey client.

We faced the common challenge of building a business that required both content and users. Without users we could not get the attention of the content rights holders and without content, we obviously could not market content to users. To remedy the content issue, we not only partnered with existing distributors of independent music and film, but at one point we actually tried to start our own film distribution business called Transmission Films. In this business we acquired the rights to distribute over 100 independent films.

I would like to reiterate this fact: We were rights holders trying to generate revenue from the sale of licensed content on our very own eDonkey application! With our own library of films and partnerships with other distributors, we hoped to prove the efficiency of our application and qualify ourselves as worthy of having serious discussions with the major entertainment rights aggregators.

## V. Industry Dynamics

We compete with other P2P distributors primarily on ease-of-use, quality of search results, and speed of downloads. We have succeeded by improving the look-and-feel of our user interface, making it cleaner, simpler, and more easily navigable. We have also improved the functionality of the eDonkey software through a series of new releases that have provided for more comprehensive searches of available content, better displays of search results, faster delivery of selected searches, more features to help organize content, and greater reliability in terms of the integrity of files delivered in response to search queries.

We have received favorable consumer response according to recent studies released by industry data resource BigChampagne and research firm CacheLogic. Our user numbers have steadily increased in absolute terms as well as in terms of market share.

According to BigChampagne, the average number of P2P users online at any given time has grown by more than forty-one percent (41%) during the past year – now nearly ten million (10,000,000) – and according to CacheLogic, eDonkey's global market share has increased to approximately fifty percent (50%).

A recent study conducted by intelligent broadband network equipment maker Sandvine, confirms that eDonkey continues to lead P2P file-sharing software programs in France and Germany, which currently reflect the highest broadband usage of any nations, and are significant to our discussion here because they may represent relevant future trends for the U.S. market. According to Sandvine, in Germany, eDonkey handles about seventy-two percent (72%) of all file-sharing traffic, while BitTorrent consumes about sixteen (16%). eDonkey captures eighty percent (80%) of all French P2P traffic with BitTorrent trailing behind FastTrack and Gnutella.

In Europe, where broadband adoption has steadily outpaced the United States, upstream traffic represents up to eighty-five percent (85%) of all bandwidth consumed on broadband provider networks. Downstream P2P traffic represents about sixty percent (60%) of all bandwidth consumed. In contrast, file sharing in the UK and

North America consumes about forty-eight (48%) of total downstream bandwidth and seventy-six percent (76%) of upstream traffic.

## VI. The *MGM* v. *Grokster* Decision

In its *MGM* v. *Grokster* decision, the US Supreme Court vacated the Ninth Circuit's summary judgment that had been in favor of respondents Grokster and StreamCast. The circuit court had relied on the "Betamax Doctrine" established in the 1984 *Sony* v. *Universal* case to conclude that there had been no contributory infringement because P2P software programs Grokster and Morpheus could be used for substantial non-infringing uses.

### *A. Ruling Summary*

The High Court remanded the case to the lower courts for reconsideration of the petitioners' motion for summary judgment, additional fact finding, and possibly a trial.

It also attempted to preserve balance while introducing a new "Inducement Doctrine" by seeking to explain that one infringes copyright in a contributory fashion by intentionally inducing or encouraging direct infringement:

"We hold that one who distributes a device with the object of promoting its use to infringe copyright, as shown by the clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties," Justice Souter wrote in the Court's opinion.

In other words, the Court attempted to clarify that while a technology in and of itself, as well as its dissemination, may qualify as "legal" generally or in the abstract, an implementation of it may become part of an unlawful "inducement of infringement" scheme if designed or executed with the intention of causing infringement.

The Court rejected the "actual knowledge of specific infringement" reading of Betamax. But it also tried to retain from Betamax that absent other evidence of intent, mere distribution of a product that has substantial non-infringing uses, even with knowledge of infringing uses should – theoretically at least – not expose a distributor to contributory liability. Beyond that, Justices seemed to lack agreement regarding the limits and applications of Betamax.

Justice Ginsburg, joined by Chief Justice Rehnquist and Justice Kennedy, favored a narrower interpretation of the Betamax safe harbor: defendants need to satisfy a relatively heavy evidentiary burden to earn such shelter. Justice Breyer, joined by Justices Stevens and O'Connor, favored a broader interpretation: the heavier evidentiary demand that would result from Justice Ginsburg's stricter interpretation of Betamax would increase legal uncertainty and risk, and would have a chilling effect on technological innovation.

### *B. Parties' Actions*

Should the parties in *Grokster* not reach a settlement, the case, now remanded to a lower court for more fact finding, will likely result in further questions that appeals courts, including perhaps the Supreme Court, will need to answer.

According to published reports, StreamCast may further argue its case in the lower courts, while Grokster will likely exit the business by negotiating settlement terms with the major music labels and movie studios, presumably then supporting the conversion of its traffic to an entertainment industry sanctioned digital distribution service.

As reported, the music label plaintiffs have now also expanded their legal campaign against the current major P2P software developers by sending cease-and-desist letters to seven of the leading companies, including MetaMachine.

These letters threaten imminent litigation – not only against the companies, but also against their executives and directors – based on the music industry's interpretation of the *MGM* v. *Grokster* ruling unless the firms immediately take steps to eliminate infringement. The major movie studio plaintiffs last week announced a

new thirty million dollar ($30,000,000) initiative to combat infringement through technological solutions as well as their support for the music industry's actions.

*C. General Effects*

*Grokster*'s narrow holding supposedly meant that a technology firm could lose the benefit of a Betamax safe harbor if it makes a product capable of infringing and non-infringing uses but then affirmatively and repeatedly encourages users of its product to infringe. This sounds perfectly reasonable in theory. But in practice, the case has already reshaped the contours of the debate between copyright holders and developers of new technology far beyond such a supposedly intended limitation. In particular, the Court has offered no objective standard for the definition and measurement of such inducement. As a result, virtually every P2P distributor, including MetaMachine, cannot know with certainty how a court of law will judge its past actions.

The decision left undefined the specifics of a "safe harbor" for developers and distributors of new content distribution technologies, deferred difficult related issues for future cases, (perhaps inadvertently) encouraged more litigation, and made it harder to work secondary liability cases through to clean outcomes. The latest round of cease-and-desist letters and the reactions to them by the major P2P distributors prove the point perfectly.

*Grokster* represented a relatively easy case given what the Court viewed as clear evidence of egregious intent to induce infringement. Other cases will present harder liability questions to the extent that they present more balanced or nuanced fact patterns; in so doing they will almost certainly expose gaps, conflicts, and ambiguities in relevant legal doctrines. In particular, the case will undoubtedly come before the Court where a distributor makes no statement of "encouragement" whatsoever. I cannot resist the mental exercise: If eDonkey had simply written on its website from day one, "eDonkey is a P2P file-sharing client" would we know for sure that we had avoided "affirmatively and actively" inducing infringement? If so, then these sites will spring up immediately; if not, then the effect of *Grokster* will go beyond chilling, perhaps to the point of freezing innovation in its tracks.

Many technology companies, including eDonkey, whose products can be used for infringement will simply find themselves unable to continue operations in a Post-*Grokster* world -- not necessarily because they would lose under the new *Grokster* standard, but rather because they literally cannot afford the costs of mounting a legal defense. Companies like eDonkey must face the reality that confronting unimaginably larger opponents that can outspend small, under-funded technology companies to death makes the question of "legal" or "illegal" a moot point.

Large multinational copyright aggregators have rapidly become more aggressive in threatening lawsuits alleging secondary infringement based on inducement theories. Because the question of intent is highly fact-dependent and discovery rules will afford plaintiffs wide latitude to seek probative evidence, it will be much more difficult for defendant technology companies to win an early-phase summary judgment in these cases. The small, innovative ones will no longer be able to afford to defend themselves in the face of the far greater financial resources plaintiffs can throw into the fight.

On its face, the inducement doctrine may sound sensible, but as a practical matter this standard makes it impossible for defendant technology companies to win an early-phase summary judgment when sued for giving rise to infringement. The "Betamax Doctrine" provided a bright line rule for lawful technologies – if a new distribution technology was "capable of substantial non-infringing use," its developers and distributors could innovate without the courts looking over their shoulders; they did not have to worry about predicting the behavior of their customers. Challenges to new technologies could be wrapped up relatively quickly by applying the well-defined standards of Betamax.

Perhaps the most disconcerting argument in the Court's decision – and a good example of the massive confusion facing technology companies in the wake of *Grokster* – is one of the Court's examples that supposedly evidences the respondents' intent to induce:

> "First, each of the respondents showed itself to be aiming to satisfy a known source of demand for copyright infringement, the market comprising former Napster users. Respondents' efforts to supply services to former Napster users indicate a principal, if not exclusive, intent to bring about infringement."

Now try to imagine the consequences. If marketing to former Napster users is evidence of intent to induce infringement, could a potential advertiser be held liable for marketing to eDonkey users? I hope not – and the Senators on the committee should hope not. During the 2004 presidential campaign, eDonkey ran advertisements for both President Bush and Senator Kerry. Perhaps they were both courting the swing "Infringement Vote?"

The *Grokster* decision blurs that bright line. By opening up the question of whether the developer or distributor of a new technology had the "intent" to "induce" infringement, the Court made sure that company e-mails, advertising, and any other evidence may now be discovered in an exhausting trial proceeding, even if the technology itself has the potential substantial lawful use.

While the incumbent entertainment companies have no obligation to evolve their business models, I strongly believe that neither should the government defend their existing models. The government does not have the expertise to predict the way in which the industry should evolve nor can it possibly control the steady march of technology. It seems highly likely that the technological advances of the last twenty years will have a tremendous impact on the way the entertainment industry does business – but the industry participants should bear the burden of figuring out what shape that takes through negotiation and competition. Imagine if the government had decided that the automobile presented an unacceptable technological challenge to the horse-and-buggy industry and introduced legislation protecting whip manufacturers.

*D. Its Impact on the eDonkey Business Model*

To understand the impact of *MGM* v. *Grokster* on eDonkey, one must first understand our business model.

We generate revenues in four ways: First, by distributing software and advertisements to our users; second, by selling an upgrade of the eDonkey software to our users; third, by licensing our software to other companies (such as those in the Voice-Over-IP market); and fourth, by collecting royalties on content sold through the eDonkey application. I will focus on this last point, obviously the most relevant to this hearing.

Analysts estimate the potential market for the online distribution of licensed music and movie content to reach billions of dollars. Compare that to the total revenue generated by the entire P2P industry and it becomes immediately obvious that anyone in the P2P industry would much prefer to be selling digital music than selling banner advertisements. Digital Rights Management (DRM) may – or may not – be the answer, but it seems well deserving of a legitimate opportunity to succeed. Advances in DRM and payment processing solutions have made it possible for "open" P2P environments, such as eDonkey, to support the secure distribution of licensed copyrighted works – in fact, we already do distribute independent content, as described above.

In the file-sharing environment that we envisioned, rights holders would have the DRM tools and support services to manage key aspects of every transaction – and to monetize them through a variety of means such as advertising, sponsorships, cross promotion, packaging, subscriptions, and paid downloads. In fact, rights holders could control distribution not only of works they placed into P2P distribution, but also the works that consumers placed there independently. Unfortunately, before licensing content to us, the labels demanded that we control the activity of our users – something that we could not do even if we wanted to given the purely decentralized nature of the eDonkey software.

*E. Two Divergent Paths*

Increasingly, as a result of *MGM* v. *Grokster*, P2P development will likely progress down two separate paths.

One will be the corporate, profit-motivated enterprises, which likely will be forced to comply with contractual terms stipulated by major entertainment rights aggregators such as reverting to centralized indexed searches, implementing various types of filtering, operating closed networks, and offering conventional industry-sanctioned business models like the current centralized paid download stores and tethered subscription models.

A challenge will be to retain the "old P2P's" appeal to the consumer – as a terrific facilitator of music discovery, including some amount of free music for listening before purchasing, and for participating in a vibrant community based on sharing musical preferences.

What may get lost or ignored in this step backwards technologically is that P2P poses a different set of risks and benefits. Because it is a different "market" for music, it may well call for a different market solution.

In previous discussions with music labels, I have often gotten the sense that they perceived themselves to be negotiating *against* me. I have always believed that conversations with the labels should sound more like partnership discussions where the content owners and the distributors collaborate to develop a product offering that will be accepted by consumers and succeed in the marketplace.

It is not that I wanted more liberal business rules solely for my benefit – if we came up with a set of business rules that we loved but the consumer did not, the consumer could simply go elsewhere – to eMule, perhaps (more on this below).

The other subset will comprise the individuals, basic researchers, hobbyists, and hackers, who will continue to explore technological advances, although probably not publicly in the United States for fear of ruinous litigation prosecuted by the entertainment industry. Undoubtedly, the next generation of open P2P applications will travel even further down the road of anonymity and secrecy. They will come with more data security (encryption) and more user anonymity than anything currently available.

This will present several problems. First, it may well provide a place for users of the current P2P applications to flee, should we be unable to persuade them to convert to the new "closed" applications. Second these users will be harder than ever to locate and it will be harder than ever to prove what files these individuals are sharing – making infringement litigation virtually impossible. Third, these applications will likely be open-source (meaning no one owns them) and will be coded by people all around the world without any accountability.

It may be worth noting that MetaMachine never sought to go down this road because we believe that these features do not further the many legitimate uses of the eDonkey software – rather, they simply aid and abet the infringing uses that we have taken proactive measures to discourage.

## VII. C & D Letter

The tenor of our conversations with content owners took a turn for the worse when MetaMachine received one of the previously described cease-and-desist letters from the Recording Industry Association of America (RIAA). This threat of imminent litigation from the major music labels, coming in light of the Supreme Court's ambiguous ruling led us to conclude that, regardless of the virtue and lawfulness of our intentions and practices and our confidence that we never intentionally induced infringing activity, we did not have the resources to endure the protracted litigation that the RIAA letter presaged.

Because we cannot afford to fight a lawsuit – even one we think we would win – we have instead prepared to convert eDonkey's user base to an online content retailer operating in a "closed" P2P environment. I expect such a transaction to take place as soon as we can reach a settlement with the RIAA. We hope that the RIAA and other rights holders will be happy with our decision to comply with their request and will appreciate our cooperation to convert eDonkey users to a sanctioned P2P environment.

### *A. Its Impact on Innovation in the P2P World*

I believe that all of the existing open P2P companies in the United States will cease operation in coming months. Instead of creating new technologies, these companies will focus their energies on imitating the well-established retail models of iTunes, Rhapsody, and the new Napster. I would hardly define that as innovation.

It's hard to imagine future "open decentralized" P2P companies opening shop as American corporations. That will be unfortunate because some of the benefits of companies operating in the U.S. are that they are easy for entertainment rights holders to access, they can be held to the contracts they sign, and they can be made available to provide input to Congress. I predict that, unfortunately, innovation in this area will come to a halt.

Note that this poses grave dangers. Perhaps the hottest P2P company (or any technology company for that matter) of the moment is Skype, which eBay recently acquired for more than two billion dollars. Where was Skype founded? Not in the United States. That represents hundreds of millions of tax dollars that will not be

collected by federal, state, and local governments. Where are the Skypes of tomorrow being founded? Your best bet is to look offshore.

At the same time, more and more individual developers of innovative P2P applications will go offshore and underground and become harder to find. Let me share an experience MetaMachine had in fighting these unlawful developers, as it may foreshadow similar challenges that other P2P software providers, and therefore the entertainment industry, will face as they attempt to transition their current file-sharing traffic to closed online content reselling operations.

Some of you may have heard of an offshore underground P2P application called eMule. Our software's name is eDonkey, of course, not eMule. The vast majority of intellectual property attorneys from whom we sought counsel have advised us that in theory we have a good trademark infringement case against eMule's distributors (yes, we face our own problems protecting our intellectual property!) I even have plenty of proof of marketplace confusion. Few consumers understand the difference – even many technology industry insiders do not really understand the distinction. Not only have the eMule distributors adopted a confusingly similar name, but they also designed their application to communicate with our eDonkey clients using our protocol.

In other words, eMule clients basically camouflage themselves as eDonkey clients in order to download files from eDonkey users. As a result, eMule computers actually usurp some of the bandwidth that should be allocated to eDonkey file transfers, degrading the experience of eDonkey users. So, have we had any success trying to stop them? Is there any company to sue? Is there even a single official representative of eMule with whom to negotiate? No. I have no doubt the RIAA will have better luck finding them than we have, but it surely will not be quite as easy as finding me.

## VIII. Issues to Consider for Potential Legislation

The Supreme Court's decision has exacerbated the protracted conflict between major entertainment companies and current-generation P2P software developers. As a result of the high Court's ruling, all sides have focused their energies on legal maneuvering rather than continuing the dialogue we started before the decision came down. Indeed, many of the incumbent P2P companies have made hasty arrangements for expedited exits either from their businesses entirely or have sought refuge outside of the United States. News reports suggest that Ares Galaxy has "open-sourced" its source code, potentially paving the way for new "darknets" to form.

P2P copyright infringement can not only be dramatically reduced, but P2P also has the potential to serve as a more robust and efficient distribution channel than its predecessors for a greater diversity of content offered in a larger variety of ways. But to do so will require leading entertainment companies, P2P software distributors, and technology solutions providers to collaborate rather than litigate or retreat from participating in fear of litigation. It will require more than vainly trying to funnel tens of millions of users into closed P2P environments unless those new P2P applications meet consumers' needs. Third-party firms need to be allowed to demonstrate that they can provide adequate safeguards and entertainment content rights holders need to license their works for P2P distribution. Beyond that, P2P can also become an advanced communications medium and collaboration platform.

I cannot fathom how many paid downloads we could have sold on eDonkey if the record labels had granted us licenses to sell their content. Imagine if P2P developers could have converted a mere one percent (1%) of all downloads that have occurred in their applications over the last eight (8) years. If we accept the entertainment industry's claims that tens of billions of P2P file transfers have occurred then we have missed out on hundreds of millions of transactions that could have – should have – been consummated.

### *A. Defer to the Marketplace*

We believe that business and technical solutions should be encouraged in the private sector and that a request for any necessary enabling legislation should come only as a last resort and only based on a consensus among affected parties.

Global decentralization of the Internet has reached the point where it will be virtually impossible to stop the proliferation of P2P file-sharing technology or prevent its continuing evolution to higher levels of efficiency.

The channel has already proven to provide a highly efficient medium for legitimately marketing copyrighted works through P2P applications.

I cannot predict what models will be well-received by consumers. Just as when any new product comes into the market, any viable new P2P business model must succeed in the marketplace. The consumers – not me, not the entertainment executives, and not Congress – will determine what works and what does not. In order to maximize the likelihood of converting existing P2P user bases, I urge everyone involved to be willing to experiment and take risks with different business models. I am infinitely confident in the ability of America's entrepreneurs to come up with one or more solutions that work – but it is going to take more than one bite at the apple. I sincerely hope the entertainment companies will endorse several different ideas in order to most successfully preempt the flow of existing P2P users to noncompliant rogue applications.

*B. A Similar Precedent*

I am not here to tell the entertainment companies how to run their businesses – indeed, I do not claim to have all the answers. But I did run a content business for three years prior to working at eDonkey. I was one of a handful of senior executives who held the title of Publisher at Barnes & Noble, Inc. As such, I was in the business of selling content and, not surprisingly, I faced many of the same challenges that the executives at the major labels and studios face today. In closing, I will share a story from my experience there – again, not because I have all the answers, but because I hope that my experience might at least illuminate the conversation we are having at this hearing.

My job at Barnes & Noble was to sell as many SparkNotes study guides – I am talking about physical, printed, books, of course – as possible. But prior to my company's joining Barnes & Noble, we had been giving this content away for free on our website. I vividly recall a meeting on one of my very first days at Barnes & Noble when my boss – a very senior executive at B&N – suggested that we either take down the website or start charging for access to the website. His rationale – perfectly logical and reasonable – was that we could not possibly sell books in our retail stores if we were giving away the same content online. I disagreed vehemently, arguing that we should use the website to drive sales of books. I do not think I actually convinced him, but he let me make the call and we kept the website free.

Sure enough, among a customer base that absolutely knew that they could get the exact same content for free from our website, sales of the physical books beat all of our expectations. I have had countless conversations since then – with journalists, professors, friends – who have asked how it could possibly happen that people would spend money to buy what they could get online, legally, for free. Of course, the answer was that the books were a slightly different product – they offered a different type of convenience and portability than the free web content did. Dasani and Aquafina are also great examples that you can compete with "free." Perhaps in the ultimate sign that our model worked, our biggest competitor, Cliffs Notes, recently began offering its content free on its website. Too little, too late, though, as by that time SparkNotes' brand recognition far exceeded that of the once venerable Cliffs Notes.

The point of this story is to provide an example of extremely liberal business rules governing the use of digital content that turned out to be highly profitable to the rights holder, in this case, Barnes & Noble. When I advocate for rules that allow users to listen to an audio file quite a large number of times for free – it is not out of any "religious" belief that content should be free. I speak from experience that you can make money by giving some content away for free.

*C. Recommended Approach*

There may well be no more need for legislation in light of the recent *Grokster* decision – I honestly do not know the position of the entertainment industry on this issue. To the extent that you do consider legislation, I have a few ideas on what that legislation should cover, though I will refrain from making any specific policy recommendations:

1. Clarify the Supreme Court's ruling in *Grokster*. I cannot emphasize enough how important this is to entrepreneurs. It is one thing for low wage jobs to start going overseas; it would be quite another for companies to follow Skype's lead and take their innovations offshore to avoid the ambiguities of *Grokster*.

2. Make sure that the legislation will have the practical consequences you desire. This is more for the sake of the entertainment industry, of course. You have to assume that open source projects will grow in popularity and that data encryption and user anonymity will make it impossible to determine who is sharing what on the next generation of P2P applications. If it won't have the desired effect, then it may not be worth legislating.

3. Encourage a market solution. Tens of millions of consumers are thirsting for the content created and distributed by the major labels and studios – there will be – there must be – numerous business models that will generate immense profits from these individuals. It may be the incumbent business model or it may be a modification to that model. Or it might be a different model all together. I firmly believe that no legislation will serve us well unless it facilitates creative market solutions rather than mandates a specific outcome.

Although we have determined that we will likely not be directly taking part in the upcoming evolution of the P2P industry, MetaMachine wishes those who are continuing to address the P2P copyright infringement problem as much success as possible. We pledge our personal support to your ongoing oversight efforts, and offer whatever assistance we can provide the Committee as individual concerned citizens with respect to such efforts.

Respectfully,

Sam Yagan
President
MetaMachine, Inc.

Cc:
Orrin G. Hatch
Charles E. Grassley
Edward M. Kennedy
Jon Kyl
Joseph R. Biden, Jr.
Mike DeWine
Herbert Kohl
Jeff Sessions
Dianne Feinstein
Lindsey Graham
Russell D. Feingold
John Cornyn
Charles E. Schumer
Sam Brownback
Richard J. Durbin
Tom Coburn