

EXHIBIT 6



Attitudes towards DRM in the Independent music sector

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Some insights from interviews

ANALYSIS Abstract: Although the major music industry is usually the focus of discussions about digital distribution and DRM, Independent music is a factor whose importance is growing. This article describes attitudes and strategies along the value chain of the Independent music players: labels, content aggregators, technical service providers and distributors. The information provided is mainly drawn from interviews with these actors.

Keywords: business analysis – business models, forensic DRM, Independent labels, music sector, stakeholders

The growing importance of Independent music

Big online retailers like iTunes or MSN need Independent content to offer a broad range of music. In 2003, the market share of Independent music on the world market was 25.3 % and 19.4 % in Europe (cf. IMPALA). In the United States, Nielsen SoundScan found that content delivered by Independent-owned labels makes up 27.5 % of the retail market volume (Morris 2005). According to the British Association of Independent Music, Independent music averaged 21 % of sales in digital format in the top 75 chart of week 15 / 2005 (cf. AIM 2005). Apple's iTunes Music Store claims to offer tracks by more than 1,000 artists signed with Independent labels (cf. Apple 2005).

To better understand the DRM and online strategies in the Independent music business, we have interviewed various players along the value chain, from labels to download platforms.

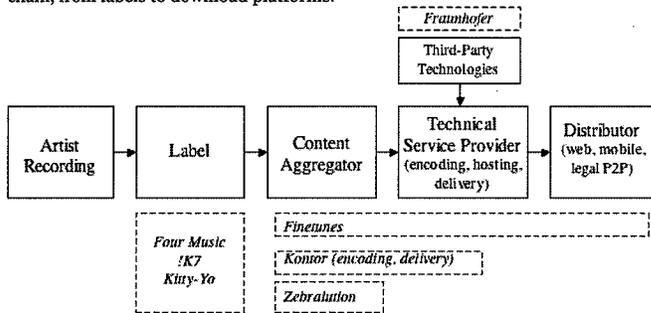


Figure 1: The value chain in the Independent music sector (Note: The companies mentioned are those interviewed. The figure is solely meant to position the stakeholders.)

Independent labels

While major labels have the market power to pursue their own DRM strategy, Indies often have to accept the license conditions of content distributors – and these requirements are often at odds with those of smaller labels.

Independent labels form a multifaceted group, ranging from very small businesses that primarily market the music of their creative founders, over labels that use the majors' distribution channels for their music, to labels that are co-owned by one of the major media concerns (EMI, Sony BMG, Universal, Warner). These affiliations also influence attitudes towards DRM.

Kitty-Yo (Berlin, 16 artists, 8 employees): If possible, the label licenses mp3 or wav-files DRM-free. But in the end, large-scale distributors, among them iTunes and musicload, decide, concedes Peter Armster, then a production manager at the label. It is only the smaller download shops that go with the label's opinion: that once a customer has bought a song, he or she should be free to do with it as pleases – within the bounds of private use, he says. DRM-enabled business models like P2P, subscription and mobile music are being considered, but not yet realized. Creative Commons Audio licenses are not used, as there is no demand on the sides of the artists.

!K7 (Berlin, Hamburg, London, New York City, Tokyo, 30 artists, 10 employees): The label's founder and CEO, Horst Weidenmüller, has taken radical steps: he has decided to abandon active DRM and the CD-covers even say so: "Copy Protection Free". The label strongly believes in the possibilities of online distribution. Distributors and labels will have the opportunity to bill one cent for a single music streaming or 20 € for a full album featuring additional content and artwork, Mr. Weidenmüller predicts.

!K7's content is sold DRM-protected via major stores like iTunes, but also via finetunes in unprotected mp3- or ogg-format. DRM supposedly is an issue raised by the major industry and reveals an anti-consumer attitude. The customer relationship should rather be one of "two-way loyalty", he demands.

Four Music (Berlin, London, 20 artists, 8 employees; note: Sony BMG holds a 50% stake): Online business amounts to less than 5% of overall sales of this label. Considerable growth is expected and online business is an important part of the market strategy. The label must abide by the policy of the download shop, but tries to bargain protection as convenient as possible for the consumer. Four's sub-label, London-based Fine Records, for example, uses Beatport (see below) without any DRM protection. If possible, the label employs watermarking, i.e. passive or "forensic" DRM. This would make copyright offenders identifiable while not restricting consumers' private usage, Markus Roth, the label's new media director, assures.

Business models that are based on active DRM – such as subscription services – are very attractive for the company, which already supplies Napster's subscription service. Legal P2P platforms such as Peer Impact are also viable distribution channels, although not at the moment. Mobile music is an option once hardware and infrastructure are advanced and affordable enough, according Mr. Roth.

Content aggregators

Online distributors cannot negotiate with every single label. Content aggregators act as rights intermediaries between Independent labels and

download shops, bundling and licensing the libraries on behalf of the participating labels and artists. They often have to act as a buffer between the needs of the labels they represent and the DRM requirements of major download stores.

Zebralution: Independent labels usually lack the personnel and financial resources to deal with major digital stores; and the stores are not interested in contacting every single independent label. Zebralution represents about 100 labels, a catalogue of 20,000 songs and supplies 150 online shops. It delivers content to major online retailers AOL, iTunes, Microsoft MSN, Sony Connect, T-Online and OD2.

According to *Sascha Lazimbat*, Zebralution's head of business, no single artist or label strictly insists on DRM protection. One of the shops the company supplies – 24-7 MusicShop – sells music by major labels DRM-protected, while it sells Independent music unprotected. Distribution over Peer-to-Peer (P2P) networks is managed using technology developed by Snocap, the company founded by Sean Fanning of Napster fame. When it comes to business models like subscription, the Independents' attitude towards DRM is more favorable. The industry expects growing demand for services like these.

A number of the Indies' songs are popular enough to be marketed as ringtones. Monophonic ringtones are protected by OMA DRM 1.0. Until OMA DRM 2.0 is fully available, main distributors stick to SDC's DRM protection (Swiss company SDC offers a Java-based mobile DRM technology). In the US, blip-tones is trying to establish itself as a download platform for ringtones based on Independent artists' music.

Kontor New Media: A competitor to Zebralution, Kontor represents Independent labels dealing with download, mobile, subscription and P2P platforms. With consumer satisfaction in mind, *Michael Pohl*, head of new media, prefers watermarked mp3 files. He explicitly mentions Fraunhofer's Light Weight DRM system (see below). Kontor delivers content to major online retailers AOL, iTunes, Microsoft MSN, Napster, Rhapsody, Sony Connect, and OD2. Both companies also offer consultancy, marketing and coaching services.

The German Association of Independent Labels and Producers (VUT) also fulfils functions of a rights intermediary. For example, it offers members a frame contract if they want to make their libraries accessible to subscription services like Napster. It is interesting to note that VUT has decided not to supply subscription services like Yahoo! Music Unlimited. This is because the service openly acknowledges offering music to sell advertisements for its websites, says Eva Kiltz, VUT's general manager. This attitude hints at the self-image of the Independent business: to make money but at the same time uphold artistic credibility.

Third-party technologies

One technology already mentioned earlier is digital watermarking. With the help of a watermark, the person who has bought a certain file can be tracked back in case of infringement. However, the technology does not actively limit the consumer's usage rights.

Light Weight DRM: The Fraunhofer Institute for Digital Media Technology – a German institute for applied research and part of the Fraunhofer Gesellschaft – has realized the needs of Independent music distribution. Light Weight DRM (LWDRM) is a passive DRM system that combines watermarking technology with a personalized digital signature. LWDRM permits copying of content for private use. Due to the personal signature, illegally shared files can be tracked. Thus, the system provides both for the consumer's and the content provider's need for convenience or security respectively. It is employed by download shops such as finetunes (see below). Of course no DRM system – be it active or passive – is completely unbreakable as *Patrick Aichroth* of the Fraunhofer Institute confirms.

Audible Magic: One of the leading British Independent labels, V2, has just signed an agreement with Audible Magic (Business Wire 2005). Audible's technology allows the tracking of files registered with their database within P2P networks, using digital fingerprints. *Beth Appleton*, V2's new media and business development manager, stresses the importance of a good relationship between content providers and consumers to make this business model and security system work: "we trust that they [i.e. the consumers] understand the implications of sharing such files illegally".

Online distributors

In order to distribute music online, there must be download portals selling the library catalogues of labels and artists. They are the digital equivalent to the traditional "brick and mortar" record stores. Some platforms specialize in Indie music and their attitude towards DRM is very much in sync with the content providers – unlike major platforms like iTunes or musicload that usually comply with the majors' DRM strategy.

finetunes: The company offers distribution and encoding services, an own download shop and white-label shop solutions. The shop solutions are licensed to anyone establishing their own online distribution system (labels, Internet service providers, retail brands, music magazines, etc.).

According to *Felix Segebrecht*, head of marketing and shop solutions, finetunes employs a proprietary watermarking system along with Fraunhofer IPT's watermarking system. Active DRM would increase support-expenditures due to interoperability problems between devices and systems.

Mr. Segebrecht distinguishes between two different subscription schemes: renting music (like Napster To Go) or subscription to a fixed number of tracks per month for a bundled price. Superdistribution with peers receiving a cut from profits is regarded to be rather unattractive from the consumers' perspective – they can hardly be expected to enrich themselves by selling music to their friends. If it spots copyright offenders operating within P2P networks, finetunes usually does not take legal action, which is considered to be too costly. Sales figures are climbing despite online piracy. Fighting infringement is a moral, rather than a legal and technological challenge: an "honest" offer in combination with "gentle pressure" and mutual trust is expected to prove a successful strategy.

Beatport: This online distributor is deeply rooted in the dance-music scene. It caters to fans of this genre, a large proportion being DJs. The music is formatted in high-quality mp3, mp4 or wav, usually featuring 320 kbit/s compression. Beatport completely abstains from active DRM protection. It would not be acceptable in a tight-knit music community that is based on mutual trust, says the company's director of European sales, *Ronny Krieger*. As about two-thirds of the customers are DJs (amateurs included), files must be compatible with Native Instrument's Traktor DJ-software, which does not support any active DRM system.

Also, the portal is not interested in DRM-based business models. Subscription is not an attractive option for the customers. Pre-listening 30-second snippets does not make sense, given the notorious length of dance-music songs. All files are watermarked. Customers either accept this policy or simply do not care. A song watermarked by Beatport has been spotted on P2P networks only once (P2P networks are not tracked systematically, however). The company issued the offender a caution and refrained from engaging in a lawsuit.

Again, among the labels using the portal for online distribution, there is not a single one insisting on DRM-protection, Mr. Krieger affirms. The company feels that legitimate buyers of digital music should not have less usage rights than those downloading pirated material.

Bottom line

It is interesting to note three major differences for the Indies in comparison to the majors' perceived strategy of active and extensive DRM-protection. First, the smaller and more independent the label, the more sympathetic it is to consumers' convenience and perceived rights. Second, Indies try to avoid active DRM whenever possible. But they acknowledge that this decision is up to the distributor. Third, Independent labels' preferred DRM strategy is a passive one: watermarking. They feel that this does not limit their customers' convenience and at the same time identifies users in case of infringement.

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