File-Sharing on the Internet

by Gemma Collins & Tom Flanagan

When the federal election writ was dropped in November 2005, legislative casualties included the long-awaited copyright reform package known as Bill C-60. The most important part of the proposed update to the Copyright Act was its attempt to outlaw P2P ("peer-to-peer") file-sharing of music over the Internet. We believe the new government should think twice before bringing this feature of C-60 back to Parliament.

The amendment would have given copyright holders a monopoly to "make available" protected material to the public via the Internet. However, the Orwellian term "making available" would actually render unavailable what has been freely available for years. Swapping music over the Internet is not illegal in Canada, and thousands of people do it every day, protected by the Federal Court's decision in *BMG Canada Inc. v. John Doe.*

In 2004, the Canadian Recording Industry Association asked the federal court to compel Internet service providers to disclose the names of their customers making music available over P2P networks. The court found that, in the absence of an explicit provision in Canadian copyright law, there was no case for the claim of infringement. A subsequent appeal was dismissed. These permissive decisions would almost certainly have been different if C-60 had been in effect at the time.

Ever since John Locke, we have known that property rights are a response to scarcity. If there were always "enough and as good left in common for others" (Locke [1690] 1980, p. 19), we would not need an elaborate legal system to create and protect property rights.

The leap from Lockean real property to intellectual property has always been dubious because scarcity seems absent in the latter case. Making use of someone else's ideas is different from dipping into someone else's acorn pile. Acorns get consumed, but ideas grow rather than diminish as they are borrowed. No less an authority than Friedrich Hayek called intellectual property "forced scarcity" (Hayek, 1988, p. 36) and questioned whether or not copyrights and patents have actually increased literary creativity and technical inventiveness.

More recently, libertarian legal theorists have been developing a related critique of intellectual property based on the distinction between negative and positive externalities, i.e., side effects felt by someone other than the primary actors in an exchange (Lemley, 2005). The sight of a well tended flower garden is a positive externality, pleasant for passers-by to look upon. But the gallant viewer who stops to pick some of those posies to give to his girlfriend imposes a negative externality upon the owner of the garden. Property rights aim to incorporate externalities into the market cost of goods to stop free riders from profiting at the expense of others.

In the case of material property, the externalities to be captured are mostly negative. CDs, books, or seats in movie theatres are scarce physical resources that need legal protection against those who would take them without payment.

Intellectual property, in contrast, involves mainly positive externalities. You are not taking anything tangible from Mr. Green Thumb when you enjoy his garden; you are just taking a look. Similarly, uploading a CD so that someone else can listen to it does not mean that there is one less CD to sell, as would be the case were you to steal it from a music store. P2P file-sharing is no more a threat to the music industry than radio was; the only difference is the medium of broadcast.

Despite the "making available" provision having been available for some time now to American litigants, over 15,000 law suits have yet to curb file-sharing. In fact, BigChampagne On Line Media Measurement, which conducts marketing research on file-sharing networks, reports that file-sharing in the US doubled between 2003 and 2005 (PCPro, 2005). Here at home, Bill C-60's online FAQ cautions that file-sharing remains a challenge in other countries where "making available" has been legislated (Government of Canada, 2005). Not only

Gemma Collins is a graduate student in the Department of Political Science at the University of Calgary. She is writing a Master's thesis on intellectual property rights. Tom Flanagan is a professor of political science at the University of Calgary and a Fellow of the Royal Society of Canada.

is this new aspect of copyright law shaky in theory, it seems ineffective in practice.

Canadian musicians speak out

A group of world famous Canadian musicians have recently added their voices to the debate. The Canadian Music Creators Coalition, with members such as the Barenaked Ladies, Sarah McLachlan, Chantal Kreviatzuk, and Sum 41, argues that suing music fans is both destructive and hypocritical. The CMCC website states that "laws enabling these suits cannot be justified in our names. We oppose any copyright reforms that would make it easier for record companies to do this" (CMCC, 2006).

At least one Canadian music industry executive agrees. In response to an infringement suit launched south of the border by the Recording Industry Association of America, Terry McBride, CEO of Nettwerk Music Group, offered to pay all the legal expenses and any possible fines for the defendant. David Greubel, father of four, stands accused of downloading and/or making available for upload, among other titles, an Avril Lavigne hit. Lavigne is a Nettwerk management client and CMCC member. "Suing music fans is not the solution, it's the problem," says McBride. "The current actions of the RIAA are not in my artists' best interests" (quoted in Market Wire, 2006).

Undoubtedly, there has been a recent decline in global record sales. The Canadian Recording Industry Association's web site notes that Canadian sales have declined $465 million in the last five years (CRIA, 2006).

However, as a report commissioned for the Canadian Ministry of Heritage notes, cycles of boom and slump in the music industry are nothing new and can be traced as far back as the 1920s. The study concludes that, "to place the burden wholly or partly on illegal downloads from the Internet is to ignore a host of other reasons" (Allison, 2004, p. 73).

The rise in popularity of rival entertainment media such as video games and DVDs, a 14 percent drop in the number of albums released from 1999 to 2002 (Wilcox, 2003), and a possible backlash against recording industry tactics number among the other potential explanations for the decline. One study suggests that record sales in the 1990s may have been artificially high as individuals replaced older formats with CDs (Liebowitz, 2003). Movies, software, and video games represent a large proportion of downloaded content, and these industries have flourished since the advent of file-sharing (Oberholzer-Gee and Strumpf, 2005, pp. 35-6).

There needs to be a regime in place to compensate creators and encourage creative work. As Heritage Minister Bev Oda has noted, a balance between creators and consumers must be the goal of sound copyright legislation. But "making available" ignores the perspective of the consumer in favour of the producer, while resorting to draconian interference with personal liberty.

Canada signed the 1997 WIPO Internet Treaties, but we have not yet ratified them by enacting their provisions into our domestic law. There exist many alternate policy directions to pursue. However, enacting a law in order to sue hundreds of fans when millions download is, as one legal scholar has remarked, "a teaspoon solution to an ocean problem" (Picker, 2002, p. 442).

continued on page 21

Digital Copyright Reform: A Portal to the Information Age

by Graham Henderson & Richard Pfohl

As the rest of the world rockets into the Information Age, in which the key marketplace is the digital realm and the key asset is intellectual property (IP) rights, Canada's copyright law remains mired in a pre-digital era.

An international consensus has developed on the need to protect IP rights in the digital forum. All of Canada's major democratic trading partners have already ratified the World Intellectual Property Organization Treaties on digital copyright (the WIPO Treaties), leaving Canada as a lone holdout.

In the companion piece to this article, Gemma Collins and Professor Tom Flanagan argue against Canada joining these ranks by fulfilling its WIPO commitments. The argument is based on the mistaken notion that the "making available" right in the WIPO Treaties is premised upon entitling rights holders to sue users of unauthorized file-swapping networks, an activity mistakenly described by the authors as "protected" under Canadian law.

The key purpose of digital copyright reform is not to enable lawsuits against individuals. It is about creating legal certainty to enable new digital business models that will allow Canada's economy—and culture—to flourish in the Information Age, alongside those of our major trading partners.

File-swapping is not legal in Canada. The companion article cites a 2004 court case as establishing that "swapping music over the Internet is not illegal in Canada." But the Federal Court of Appeal unanimously rejected that lower court ruling, concluding, "This technology must not be allowed to obliterate those personal property rights which society has deemed important" (*BMG Canada*, para. 41).

The "making available" right simply clarifies that in the digital world, as in the physical world, the creator (or subsequent rights holder) has the right to decide when his or her work is published or distributed (Reinbothe and von Lewinski, 2002). After all, that is the key to their livelihood in the digital world.

It is not surprising that the key incubators of innovative business models to distribute software, games, books, music, movies and other IP products to consumers are countries that have implemented the WIPO Treaties (see table 1).

Canada's lack of legal certainty has doomed us to lag behind these countries in the digital business environment, despite one of the highest broadband penetration rates in the world. Canada's digital on-line music market is roughly 2 percent of the US market, instead of the 12 to 15 percent that it should be given relative broadband distribution. In the United Kingdom and Germany, the number of regular buyers of legal downloads now exceeds the number of regular unauthorized file-swappers (IFPI, 2006a, p. 15). In Canada, by comparison, unauthorized file-swapping swamps legal sales on the order of 100 to 1 (IFPI, 2006b, p. 11).

A study conducted for the Business Software Alliance revealed that levels of software theft in Canada are approximately 9 to 15 percent higher than those in our major trading partners that have enacted the WIPO treaties (Canadian Alliance Against Software Theft, 2005; Business Software Alliance, 2005). Canada's additional software theft costs us 14,000 jobs and $8.1 billion in lost productivity (Canadian Alliance Against Software Theft, 2005; Business Software Alliance, 2005). Beyond that, investors are reluctant to invest in Canada's traditional copyright industries, such as new music companies, and in new innovative digital businesses.

Why buy it when you can get it free?

The companion article ventures that there are no negative externalities associated with intellectual property theft, because intellectual property is not a "scarce" resource. While the authors are correct that online theft may not affect the *supply* of products, it ignores the effect on the *demand* side of the equation.

Graham Henderson is president of the Canadian Recording Industry Association. Richard Pfohl is its general counsel.

Table 1: Leading Markets that Have Implemented the WIPO Treaties

Country	Implemented WIPO Treaties?
United States	✓
Japan	✓
United Kingdom	✓
Germany	✓
Mexico	✓
South Korea	✓
France	✓
Australia	✓
Belgium	✓
Netherlands	✓
Austria	✓
Czech Republic	✓
Denmark	✓
Finland	✓
Greece	✓
Hungary	✓
Ireland	✓
Italy	✓
Poland	✓
Portugal	✓
Sweden	✓
Canada	×

Source: Canadian Recording Industry Association.

The effect on demand was ably explained by Professor George Barker, an expert witness in the recent, successful suit against KaZaA:

> Economic theory suggests that, for some segment of consumers, the availability of "free" MP3 files downloaded via KaZaA will likely substitute for and thus reduce the sales of CDs, cassettes and authorized digital downloads.... This is just economic common sense: why would consumers buy the music, after all, when they can get it for free? (Barker Report)

As a host of Canadian musicians cited in the companion article noted in a "friend of the court" brief successfully petitioning the US Supreme Court to shut down the notorious Grokster file-swapping service,

> If the public is allowed to copy and distribute sound recordings without compensating the creators (and those who work with them), artists' principal means of support will vanish. The destructive consequences to our culture will follow as certainly as night follows day. (*Grokster* brief p. 22)[1]

The artists concluded that unauthorized file swapping "threatens to destroy the ability of musical artists and others to sustain themselves economically... and does irreparable... harm to the ability of creators to protect the quality and artistic integrity of their works" (*Grokster* brief, p. 5). And not only musical artists, but everyone involved in the music industry is "directly threatened by the massive, unfettered copyright infringement being fostered by businesses like Grokster" (*Grokster* brief, p. 4).

Canada pays a big price for unauthorized file-swapping

Since the advent of widespread, unauthorized file-swapping beginning in 1999, the Canadian recording industry has experienced its most dramatic downturn in history. In that time, the industry has lost $558 million in annual retail sales and 20 percent of its workforce (see figure 1). These losses have dramatically affected investment in this country and had an adverse impact on the careers of many artists.

Artists who are struggling to establish a career suffer the most from massive, unauthorized file-swapping, as the experience of Jully Black, the critically-acclaimed new voice on the Canadian music scene, illustrates. Ms. Black released her debut album last year, only to have it immediately stolen and distributed over unauthorized file-swapping networks. Putative fans swapped her tracks at a ferocious rate—2.8 million requests within a period of two weeks. Meanwhile, her CD struggled to attain sales of 15,000 units.

Canada's failure to modernize its digital copyright laws exacerbates the problem. Last year, Gwen Stefani became the first artist to sell a million downloads in the US with the song "Hollaback Girl." Based on CD sales on both sides of the border, she might reasonably have expected to sell 120,000 downloads in Canada. But she sold a fraction of that: just over 25,000 downloads (see figure 2).

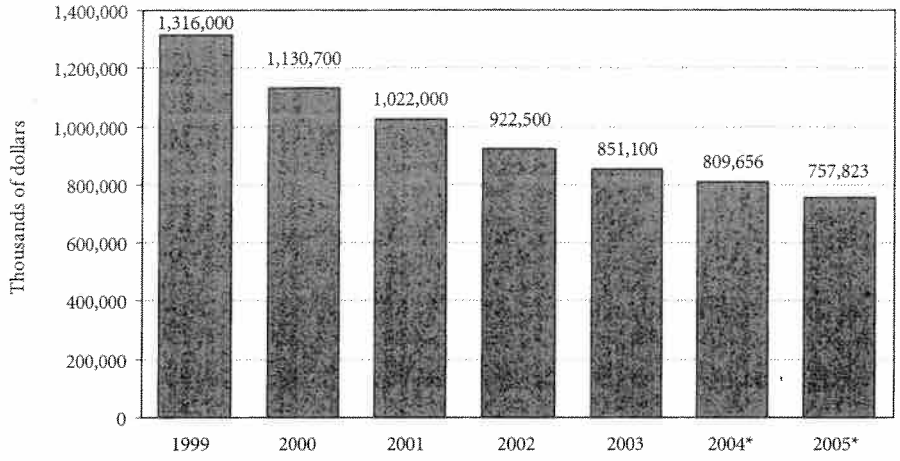
The common-sense explanation

Apologists for unauthorized file-swapping venture any number of alternative hypotheses for the recording industry's dramatic downturn. The companion article cites Professor Stan Liebowitz for the proposition that sales prior to the advent of file-swapping were artificially inflated. In fact, Dr. Liebowitz rejected this hypothesis and came to precisely the opposite conclusion:

> My conclusions, in a nutshell, are that MP3 downloading does appear to be causing harm. No other explanations that have been put forward seem to be able to explain the decline in sales that have occurred since 1999. (Liebowitz, 2003, p. 231)

Based on the most comprehensive studies of the issue, as well as surveying every other study done to date, Dr. Liebowitz found a "close linkage between changes in file-sharing and changes in record sales." He concluded

Figure 1: Decline in Canadian Recording Sales Since the Advent of File Swapping



*Note that the 2004 and 2005 figures include digital sales.

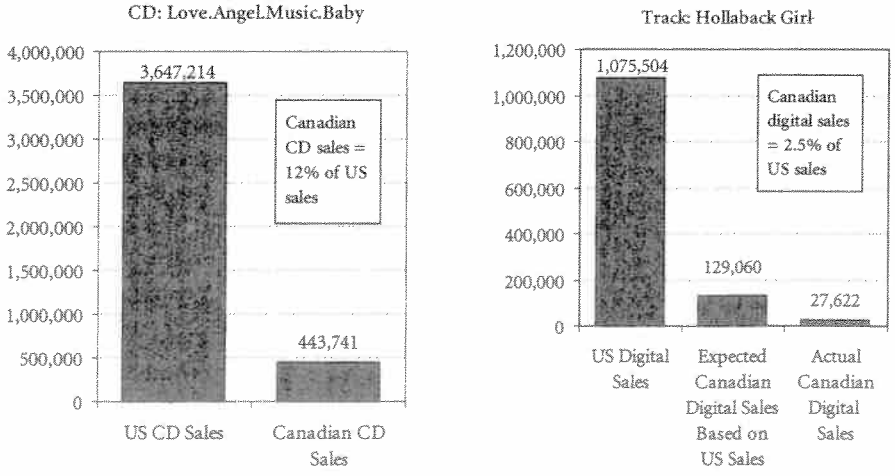
Source: Canadian Recording Industry Association.

that unauthorized file-swapping "has brought significant harm to the recording industry" (Liebowitz, 2006, p. 24).

Dr. Liebowitz examined each of the alternative hypotheses advanced for the devastating downturn in the music industry and concluded:

> *[A]nalysis of the various possible alternative explanations for the decline in CD sales fails to find any viable candidates. This conclusion ... should not be much of a surprise. Common sense* is, or should be, the handmaiden of economic analysis. When given the choice of free and convenient high-quality copies versus purchased originals, is it really a surprise that a significant number of individuals will choose to substitute the free copy for the purchase?" (emphasis added) (Liebowitz, 2006, p. 24)

Figure 2: Digital Sales of Gwen Stefani Album and Single in the United States and Canada



Source: Nielsen SoundScan, April 28, 2006.

As the Canadian musicians stated in their successful *amicus* brief to the US Supreme Court: "It cannot be reasonably disputed that the principal reason for this catastrophic harm is the proliferation of businesses like Grokster" (*Grokster* brief, p. 26).

Conclusion

The companion article characterizes adopting the "making available" right as a "draconian interference with personal liberty." But there is no liberty under Canadian law to steal someone else's intellectual property, any more than there is freedom to steal tangible property. As the Supreme Court of Canada has recognized, copyright ensures that creators receive their just rewards for their creations (*Galerie d'Art Petit Champlain*).[2]

The companion article correctly states that "There needs to be a regime in place to compensate creators and encourage creative work." Fortunately, there is such a regime: copyright. As the Federal Court of Appeal stated, copyright doesn't conflict with the public interest, it *promotes* the public interest by encouraging the creation and dissemination of creative works and ideas (*BMG Canada*, para. 40).[3] It does so only if those who create the works can get paid for their creations (*BMG Canada*, para. 41).[4]

Our outdated legal system, which fails to recognize the tools necessary to enforce copyright in the digital realm, has condemned Canadians to compete in an uncertain digital environment, in which innovation is thwarted and

on-line businesses cannot get established. It is time that our government provides those tools to put Canada on the fast track of the Information Age.

Notes

[1]While some of these artists have stated their tactical opposition to suing individual file-swappers, the artists clearly recognize the devastating effect of file-swapping on the music industry.

[2]The Supreme Court stated that a key purpose of copyright is to obtain a "just reward for the creator" (para. 30)

[3]The court stated: "Intellectual property laws originated in order to protect the promulgation of ideas. Copyright law provides incentives for innovators—artists, musicians, inventors, writers, performers and marketers—to create. It is designed to ensure that ideas are expressed and developed instead of remaining dormant.

[4]The court stated: "Individuals need to be encouraged to develop their own talents and personal expression of artistic ideas, including music. If they are robbed of the fruit of their efforts, their incentive to express their ideas in tangible form is diminished."

References

Canadian Alliance Against Software Theft (2005). "A Lower Software Piracy Rate in Canada Could Yield $8 Billion in Economic Gains, According to New CAAST Study." Press Release (December 8).

Business Software Alliance (2005). *Second Annual BSA and IDC Global Software Piracy Study* (May).

International Federation of Phonographic Industries (IFPI) (2006a). *Digital Music Report 2006* (January).

International Federation of Phonographic Industries (IFPI) (2006b). *The Recording Industry 2006 Piracy Report* (July).

Liebowitz, Stan (2003). "Will MP3 Downloads Annihilate the Record Industry? The Evidence So Far." In Gary Libecap, ed. *Advances in the Study of Entrepreneurship, Innovation, and Economic Growth.* Greenwich, Conn: JAI Press.

Liebowitz, Stan (2006). "File Sharing: Creative Destruction or Just Plain Destruction?" *Journal of Law and Economics* 49 (April).

Reinbothe, Jorg and Silke von Lewinski (2002). *The WIPO Treaties 1996.* Butterworths LexisNexis.

Legal citations

BMG Canada Inc. v. John Doe, 2005 FCA 193 (*BMG Canada*).

Galerie d'Art Petit Champlain inc. v. Theberge 2002 SCC 34 (*Galerie d'Art Petit Champlain*).

Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd., 545 US (2005), brief of *amici curiae* Recording Artists of Coalition, Barenaked Ladies, Diana Krall, Avril Lavigne, Sarah McLachlan Sum 41, *et. al.*, filed with the Supreme Court of the United States, Jan. 25, 2005 (*Grokster* brief).

Universal Music Australia Pty Ltd v. Sharman License Holdings Ltd. [2005] FCA 1242 (Federal Court of Australia) Sept. 30, 2004. Expert Report of Dr. George Barker (Barker report).

File-Sharing on the Internet
continued from page 17

There is still time to draw back from a step that would create a new class of lawbreakers, impose censorship on the Internet, and do nothing to foster genuine cultural vitality.

References

Allison, Cathy (2004). *The Challenges and Opportunities of Online Music: Technology Measures, Business Models, Stakeholder Impact and Emerging Trends.* Report for Canadian Heritage (March 31). Digital document available at *http://www.cana- dianheritage.gc.ca/progs/ ac-ca/progs/ pda-cpb/pubs/online_music/ online_ music_e.pdf* (accessed August 21, 2006).

Canadian Music Creators Coalition [CMCC] (2006). *A New Voice: Policy Positions of the Canadian Music Creators Coalition* (April 26). Digital document available at *http://www.music creators.ca/docs/A_New_Voice-Policy_Paper.pdf* (accessed August 21, 2006).

Canadian Recording Industry Association [CRIA] (2006). Statistical Archives. Digital document available at *http://www.cria.ca/stats/1299_s.php* (accessed June 14, 2006).

Canadian Recording Industry Association [CRIA] (2006). "Facts About File Sharing." Digital document available at *http://www.cria.ca/filesharing.php* (accessed August 21, 2006).

Government of Canada, Department of Canadian Heritage (2005). Copyright Policy: Frequently Asked Questions (July 5). Digital document available at *http://www.canadianheritage.gc.ca/progs/ ac-ca/progs/pda-cpb/reform/faq_e.cfm* (accessed August 21, 2006).

Hayek, F.A. (1988). *The Fatal Conceit.* Chicago: University of Chicago Press.

Locke, John [1690]. Second Treatise of Government. C.B. Macpherson, ed. (1980). Indianapolis: Hackett Publishing.

Lemley, Mark A. (2005). "Property, Intellectual Property, and Free Riding." *Texas Law Review* 83,4: 1031-75.

Liebowitz, Stan (2003). "Will MP3 Downloads Annihilate the Record Industry? The Evidence so Far." In Gary Libecap, ed. *Advances in the Study of Entrepreneurship, Innovation, and Economic Growth.* Greenwich, Conn: JAI Press.

Market Wire (2006). "Nettwerk music group takes on the RIAA." Press Release (January 26). Digital document available at *http://www.marketwire.com/mw/release_html_b1?release_ id=107623* (accessed August 21, 2006).

Oberholzer-Gee, Felix and Koleman Strumpf (2005). *The Effect of File Sharing on Record Sales: An Empirical Analysis.* Harvard Business School, working paper (June). Digital document available at *http://www.unc.edu/~cigar/papers/ FileSharing_June2005_final.pdf* (accessed August 21, 2006).

PCPro (2005). "P2P Activity Doubles in Two Years" (October 11). Digital document available at *http://www.pcpro.co.uk/news/ 78525/p2p-activity-doubles-in-two- years.html* (accessed August 21, 2006).

Picker, Randal C. (2002). "Copyright as Entry Policy: The Case of Digital Distribution." *Antitrust Bulletin* (Summer- Fall): 423-463.

Willcox, James K. (2003). "Where Have All the CD's Gone?" *Sound and Vision Online,* (June). Digital document available at *http://www.soundandvisionmag.com/article.asp?section_id=2&article_id=453* (accessed August 21, 2006).