

IFPI:05

DIGITAL MUSIC REPORT



representing the
recording industry
worldwide

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“The biggest challenge for the digital music business has always been to make music easier to buy than to steal. That ambition is turning into reality.”

INTRODUCTION



John Kennedy, Chairman & CEO, IFPI

The biggest challenge for the digital music business has always been to make music easier to buy than to steal. At the start of 2005, as the legitimate digital music business moves from a niche market into the mainstream of consumer life, that ambition is turning into reality.

As this report testifies, 2004 has seen an amazing change in the digital music landscape. And the market will grow apace in 2005. Here are some key highlights from this report:

- **Record companies have digitised and licensed over a million songs.** In 2004 the available catalogue on the biggest online services doubled from around 500,000 to around one million tracks
- **The number of online services where consumers can buy music has increased four-fold to more than 230 worldwide – and over 150 of those are in Europe**
- **Services like iTunes and Napster have become household names internationally – but local repertoire services in many countries are also developing fast**

Digital music is moving into the mainstream of consumer life

■ **The digital download market is growing geometrically** – in 2004 downloaded tracks rose more than ten-fold to over 200 million in the US, UK and Germany combined

■ **Record companies have seen their first year of significant revenues from digital sales** – from practically zero to several hundred million dollars. Jupiter thinks this will double in 2005

■ **Digital sales could rise to as much as 25% of total sales in five years**, according to some record companies and third party analysts

■ **Consumer attitudes are changing** – the latest IFPI European survey shows increasing awareness of, use of, and intentions to use, legal download services

Legitimate online music services have done what some thought only a year ago was unthinkable: they have proved that they can take on the unauthorised free alternatives. Online music today offers unbelievable value for the consumer: for 99 cents in Europe – the price of a loaf of bread, a bus fare, a can of Coke – you can download a piece of music that will stay with you for life. For those who claim they took music for free because there was no digital legal alternative, there is no longer any excuse.

However, making the catalogue available is only one side of the story. We can't just promote

online music, we have to protect it as well. Today's legitimate digital music market is evolving in such an extraordinarily adverse climate that it is almost a miracle that it has been able to grow at all. What other business has had to break into a 100% pirate market?

Anti-piracy enforcement is a critical part of the recording industry's digital strategy. And it has proved an effective one too. By sending the simple message that unauthorised file-sharing is illegal and could lead to significant financial or even criminal penalties, we are helping to create the breathing space the legitimate services need. In 2004 the industry launched over 7,000 legal actions in North America and Europe. There will be a lot more cases in more countries in 2005.

As an industry we are embracing technology on one hand while fighting the abuse of technology on the other. The start of 2005 sees record companies discussing with technology firms the best way to harness peer-to-peer for commercial use. If a legitimate and viable commercial business results, based on the payment and permission of right holders, this could be a very exciting development for the online music business in 2005.

Another major development will be the wider consumption of music on mobile phones. Some estimate that 50% of mobile content revenues will be from music.

One important problem that hinders growth of the online music business is the lack of

interoperability between services and devices. The danger is of wide-scale consumer confusion and wasted opportunities in a market which has extraordinary growth potential. There is no easy solution, but all players in the online market need to work harder to solve this problem in 2005.

If 2004 was the year record companies digitised and made available their repertoire in bulk, then in 2005 our industry priority is simply this: we must market, promote and sell music, for download, hire, subscription, wherever and whenever we can. Record companies want to license the music – to as many services, for as many consumers, on as many formats and devices for use in as many places and countries as they can. There are straightforward conditions: the business must be legitimate; the music must be correctly licensed by its rightholders, and record companies and other right holders must get properly paid.

I am confident that in twelve months' time the digital music market will have grown very significantly around the world. A sector that currently accounts for a very small percentage of the industry's revenues is poised for take-off in the next few years. At long last the threat has become the opportunity.

IFPI's role in this is clear: promoting legal services; educating governments and consumers about this new market; and aggressively tackling internet piracy. These will be our big challenges in 2005.

“The emergence of a successful digital business has been the single most important development in the music industry in 2004.”

THE LEGITIMATE DIGITAL MARKET TAKES OFF

The emergence of a successful digital business has been the single most important development in the music industry in 2004.

Services around the world proliferated. By the end of 2004, IFPI's global tracking on the www.pro-music.org website counted over 230 services that offer online music legally, up four-fold from 50 a year earlier and 20 in January 2003. More than ten services operate in at least three markets. In Europe alone, there are over 150 online music services available in 20 countries.

The mobile market for music is also expanding rapidly, as 3G and mobile music services enter the market.

GLOBAL BRANDS EMERGE

Brands like Apple's iTunes, Napster, Sony Connect and MSN Music, have spread internationally to multiple territories during 2004. The global leader, iTunes, unveiled its service in the UK, Germany and France in June 2004, and then in a further nine markets in Europe during October. Apple reported sales of five million songs in the first ten weeks of operation in Europe. Globally, iTunes reached sales of 230 million tracks since launch. iTunes reached Canada in December and is expected to launch in Japan in 2005.

Napster, one of the world's most recognised digital music brands came to the UK and Canada in May 2004 and has focused on local repertoire. Sony Connect

launched in the US in April and in key European markets in July, while Rhapsody is expected to do so in 2005.

Microsoft's MSN Music – which first launched in 2002 through the OD2 platform in the UK, France, Germany, Italy and Australia – expanded to eight more European markets in November. Microsoft is marketing the 'Plays For Sure' message emphasising the wide compatibility of the Windows Media Audio format with online music services and portable digital players.

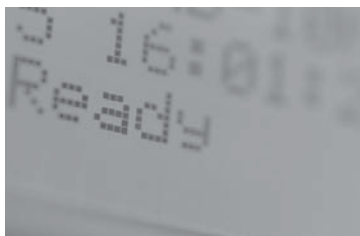
A number of local services joined the market across continental Europe in 2004. These range from charity download sites to services that specialise in local repertoire such as T-Online's

Musicload service in Germany, Rosso Alice in Italy and Archambaultzik.ca in Canada, which are gaining in popularity and rivalling global services. Musicload is the current market leader in Germany, reaching the one million monthly downloads mark in December 2004 (a level 80 times higher than at launch in October 2003). Other online stores are bundled with local broadband providers or linked to local music retailers.

The most advanced digital markets in Europe are the UK, with over 30 services, followed by Germany and France with more than 20 and 10 services respectively. Some of the main services in each market are shown opposite.

MUSIC SERVICE LAUNCHES IN 2004

JANUARY	MARCH	APRIL	MAY	JUNE
MyCokeMusic: UK	Wal-Mart: US	Sony Connect: US MSN Music: Australia	Napster 2.0: UK, Canada MyCokeMusic: Austria	iTunes: UK, Germany, France
JULY	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER
Sony Connect: UK, Germany, France	Virgin Digital: US	iTunes: Austria, Belgium, Finland, Greece, Italy, Luxembourg, Netherlands, Portugal, Spain MSN Music: UK, France, Germany, Italy, Netherlands, US, Japan	MSN Music: Belgium, Spain, Norway, Denmark, Sweden, Finland, Austria, Switzerland MyCokeMusic: Switzerland Tesco: UK	iTunes: Canada



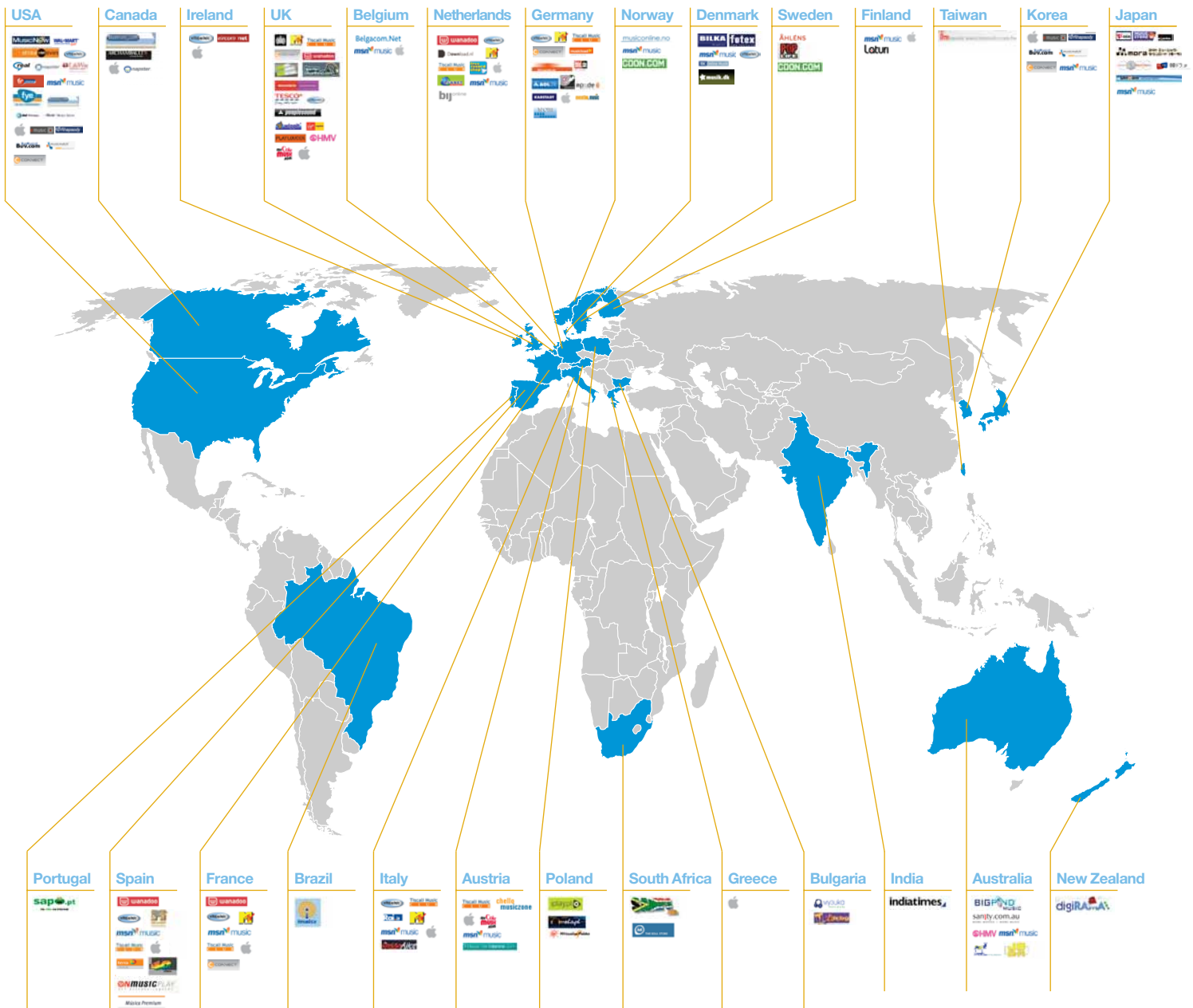
KEY FACTS OF 2004:

AVAILABLE REPERTOIRE
DOUBLES TO AROUND
ONE MILLION TRACKS

NUMBER OF SITES UP
FOUR-FOLD TO 230
WORLDWIDE

DOWNLOADS UP MORE
THAN TEN-FOLD TO OVER
200 MILLION IN THE US, UK
AND GERMANY COMBINED

DIGITAL MUSIC SERVICES EXPAND INTERNATIONALLY



“ITUNES REALLY COMPETES WITH PIRACY, NOT WITH THE OTHER SERVICES. PIRACY IS THE BIG ENEMY. BUYING MUSIC ONLINE LEGALLY IS GOOD KARMA.”
STEVE JOBS, CEO OF APPLE

SALES AND SUBSCRIPTIONS

The US remains the global leader in online music sales and subscriptions, but Europe is making headway.

Sales of single track downloads (excluding downloads sold as albums and song streams) in the US for 2004 rose to 142.6 million, up from 19.2 million in the second half of 2003 (when Nielsen SoundScan began tracking downloads in the US). Album downloads totalled 5.5 million.

In the UK, the largest European download market, total downloads rose from practically zero to 5.7 million (UK Official Chart Company/BPI).

Subscription services are growing steadily in the US. Paying subscribers for the major services – Rhapsody, Napster, MusicNet, MusicMatch and eMusic – more than doubled in a year to some 1.5 million (December figures). Virgin Digital launched in the US in September 2004 – another big brand expected to boost the subscription-based sector.

Subscription services outside the US are also growing; Napster (UK), Wippit (UK), Vitaminic (Europe) and E-compil (France) are examples.

BUILDING CATALOGUE

The music consumer can today shop or browse in online services that offer a bigger catalogue than all but the very largest physical megastores.

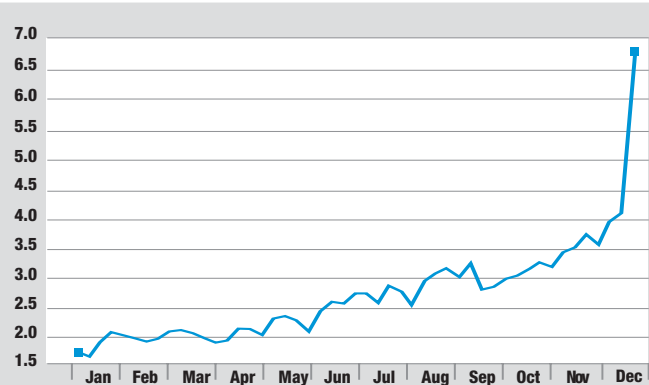
Music catalogues available through online services have grown steadily. In the US, iTunes, Napster and Rhapsody expanded their catalogues from 500,000 tracks to over one million during 2004. In Europe, services powered by OD2 (including MyCokeMusic and Tiscali Music Club) expanded their catalogues from 300,000 to 600,000 tracks, with MSN reaching one million tracks. In Europe Napster reached one million songs, available for streaming through a subscription, after agreements with independent labels.

This is a dramatic increase in available repertoire. A catalogue of one million tracks is equivalent to around 80,000 albums – larger, for example, than most megastores.

“2004 HAS BEEN A LANDMARK YEAR FOR THE MUSIC INDUSTRY. THE DIGITAL SERVICES HAVE GIVEN THE INDUSTRY THE SHOT IN THE ARM IT NEEDED – STIMULATING THE PUBLIC’S APPETITE FOR CONSUMING MUSIC WHILE GIVING THEM A SUPERIOR, LEGAL ALTERNATIVE TO THE P2P SITES. AS BROADBAND PENETRATION BECOMES MORE WIDESPREAD, THE DIGITAL SERVICES WILL TAKE EVEN GREATER HOLD AND CONTINUE THEIR EXPANSION INTO BOTH ESTABLISHED AND EMERGING MUSIC MARKETS. THROUGH 2005 AND BEYOND WE WILL CONTINUE ROLLING OUT NAPSTER AND OUR NEW PORTABLE SUBSCRIPTION SERVICE ‘NAPSTER TO GO’ INTERNATIONALLY, WITH CAREFULLY TAILORED SERVICES THAT CATER FOR AND RESPECT LOCAL DIFFERENCES AND REPERTOIRE.”

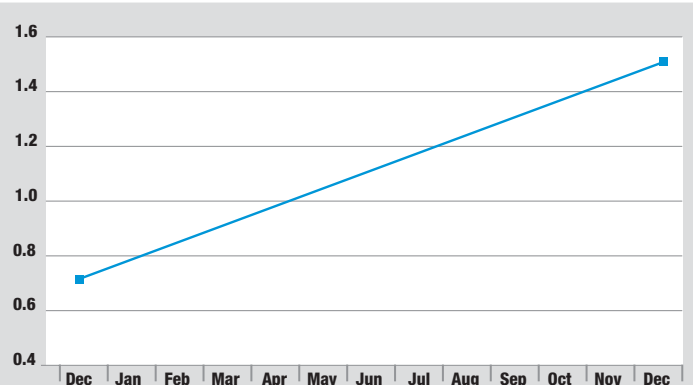
CHRIS GOROG, CHAIRMAN & CEO OF NAPSTER

US DIGITAL WEEKLY SALES 2004 (MILLIONS)



Source: Nielsen SoundScan, single track downloads only (excluding album downloads and streams)

GROWTH IN US SUBSCRIBERS TO MUSIC SERVICES (MILLIONS)



Source: Rhapsody, Napster, MusicNet, MusicMatch, eMusic (public announcements)



THE BUSINESS MODELS

Among the major brand names, two distinct business models have emerged in digital music: pay-per-download and subscription services.

Pay-per-download services meet consumer demand to 'own' music, but with greater flexibility than CDs as tracks can be selected and downloaded on the spot. Services such as iTunes, MSN Music, Wal-Mart (US) and Tesco (UK) sell downloads from US\$0.80 per track. Tracks are transferable to portable devices and can be burned onto disk.

Subscription services offer a very wide choice of music for a monthly fee, allowing users to access all the music they want with the option to purchase selected tracks. Services like Napster, Rhapsody and Virgin Digital offer streaming and radio-play access for a monthly fee – typically from US\$9.99. Downloads and burns are available for an extra per-track fee from US\$0.79. Some subscription services such as Napster now allows 'tethered downloads' which are transferable to portable players for as long as the consumer remains a subscriber.

GROWTH OUTSIDE EUROPE AND THE US

Online services have expanded outside Europe and the US, with over 40 online music services now available. Notably, the Asia-Pacific region has seen a big increase in online services.

In Australia, NineMSN became the first OD2-powered service to launch outside Europe. In October 2004 the service launched a co-branded store with HMV offering both digital and physical music products. Meanwhile digital service provider Destra, which powers JB Hi-Fi, Sanity and ChaosMusic among others, increased its catalogue from 100,000 to 500,000 tracks during 2004.

Soundbuzz has also expanded its operations in Asia-Pacific by partnering with Singapore's Creative Technology. The partnership allows users of Creative's portable digital music players access to Soundbuzz's Digital Music Store. The Soundbuzz/Creative package has been available in Singapore since July and was rolled out in Australia, India and South East Asia at the end of 2004.

In Canada, a number of online retailers have joined existing service Puretracks by launching their own music services during 2004. These include Archambaultzik, Sympatico Music Store, Bonfire@Future Shop, Napster and iTunes.

Musica is South Africa's first online service, launched in December 2004. The service debuts with 400,000 tracks and is powered by OD2.

In Latin America, the digital music market is developing despite low broadband and portable player penetration. Brazil's iMusica is the only service provider in the region, powering MSN Brazil and iget. US-based services specialising in Latin repertoire have developed in 2004, including emepe3.com and emusiclatino.com. Other services are due to launch in 2005, indicating growing demand for digital Latin music.



The screenshot shows the Pro-Music website interface. At the top, there are navigation links: "making music", "artists speak", "music online", "viewpoints", "free music?", and "on copyright". The main content area is titled "music online" and features a section "Use a legitimate site - it's worth it!". Below this, it lists several digital music services with their logos and websites:

- Apple: www.apple.com/uk
- Belgian Music Online: www.belgianmusiconline.be
- Bleep: www.bleep.com
- Message: Messaggerie Musical! www.messaggerie.net
- Ministry Of Sound: www.ministryofsound.com
- MSN: www.msn.co.uk

At the bottom of the screenshot, a text box reads: "For a comprehensive directory of services visit www.pro-music.org".

"WHAT SETS US APART FROM THE REST? WE WANT TO HAVE RELEVANT CONTENT AVAILABLE FOR CONSUMERS IN ALL OUR TERRITORIES. INCREASINGLY, PEOPLE WILL WANT TO BUY A REAL MUSIC ARTIST PRODUCT AND WILL WANT TO GET CONTENT THAT'S RELEVANT. IN FRANCE, FOR EXAMPLE, OVER HALF OF THE ALBUM CHART IS MADE UP OF LOCAL ACTS. YOU CAN'T BUILD AN ONLINE SERVICE FROM JUST INTERNATIONAL CONTENT, OR YOU WON'T SURVIVE IN THE MARKET." GREGOR ERKEL, DIRECTOR OF SONY NETWORK SERVICES EUROPE (SONY CONNECT)

“Music on mobile phones is set to become a significant source of revenue for record companies.”

THE MOBILE MUSIC MARKET

Music on mobile phones is set to become a significant source of revenue for record companies. Music via mobiles has quickly evolved from ringtones, to the use of full audio recordings in ringtones, ringback tunes, full-track downloads and other multimedia applications. With the advent of 3G technology, consumers can get a range of interactive content, including music tracks and video, at higher speed and better quality.

Mobile phone handsets have quickly evolved from talking devices into fully-fledged entertainment gadgets, and consumers are increasingly familiar with the concept of buying music through their handsets.

ASIA LEADS THE WAY

The mobile music market is already big business in Asia, particularly in Japan and South Korea, where 3G is advanced and handset penetration is high. There is also a wide range of products and services available in those markets, from ringtones (launched as far back as in 2002) to dedications, ringback tunes, video and TV streaming services. In both markets, mobile music sales have easily outsold online downloads.

Japan has a ringtone market worth an estimated US\$100 million in 2004. Label Mobile is the largest distributor in Japan, with a catalogue of 80,000 tracks from 19 record companies. By November 2004 Label Mobile was selling a monthly average of 12 million ringtones. Operator KDDI began offering full-track downloads to mobiles in November 2004 and was expected that the one million sales mark would be reached by the end of 2004.

In South Korea, where the market has expanded beyond ringtones into full-track downloads, the mobile music market (including ringtones, ringtones and full-track downloads) was worth an estimated US\$158 million in 2003. China is also a growing mobile music market with mobile subscribers reaching 290 million (around 20% of the population).

3G LAUNCHED IN EUROPE

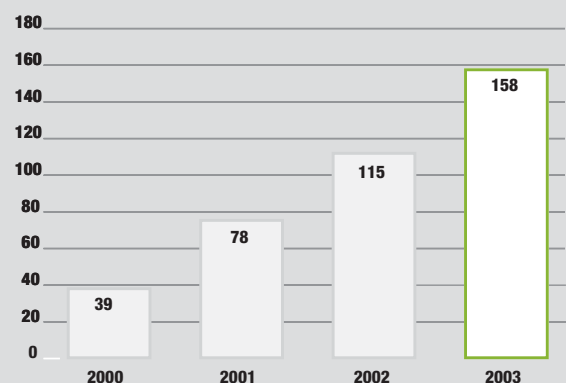
In Europe, 2004 was a breakthrough year with a number of key service launches and the roll-out of 3G networks. Vodafone launched a 3G music download service in November 2004 under its ‘Vodafone live!’ brand in 13 markets. Licensed by record companies, full-track and video downloads as well as audio and video streams are available on the service. Orange also launched 3G services in December offering full-track downloads. UK operator ‘3’ concentrates on 3G video services, offering music video, sports clips and news since March 2003.

Record companies have launched various initiatives in the mobile sector in Europe during 2004. EMI, for example, offered previews of Robbie Williams’ music video ‘Misunderstood’ in partnership with ‘3’. The artist’s latest album was also sold in memory cards compatible with handsets and handheld computers in the UK. ‘3’ also featured streamed live concert footage of the Sony BMG act Rooster.

Also available in Europe are: O2’s download service, with its own compatible portable device (Siemens SX1 Music) allowing consumers to transfer downloaded tracks from the mobile to the device; T-Mobile’s ‘Mobile Jukebox’, available in the UK, Germany and Austria offering 90-120 second music clips; and Spanish operator Telefonica Mobile’s ‘Melodeo’, offering some 30,000 tracks for download. Warner Music licensed its entire catalogue to Telefonica late in 2004.



SOUTH KOREAN MOBILE MUSIC SALES (US\$ MILLIONS)



Source: Korean IT Industry Promotion Agency (figures include ringtones, ringtones and full-track downloads)

US MOBILE MARKET EMERGING

In the US, the mobile music market is in its infancy, but growing rapidly, with an estimated 128 million mobile users. Ringtones are the main form of mobile music consumption, marked by the launch of the Billboard ringtone chart in November.

In an effort to increase sales of real recording ringtones, various operators entered into agreements with major and independent record companies. Services launched include Sprint's 'Music Tones'; AT&T's 'MmMode Music Store' whereby consumers can stream songs from a catalogue of 750,000 tracks via mobile or buy single tracks which are downloaded onto PCs; and Verizon's 'Get It Now' offer of short audio clips. In early 2005 Verizon introduced mobile video and audio services with a range of phones capable of high-speed Web surfing.

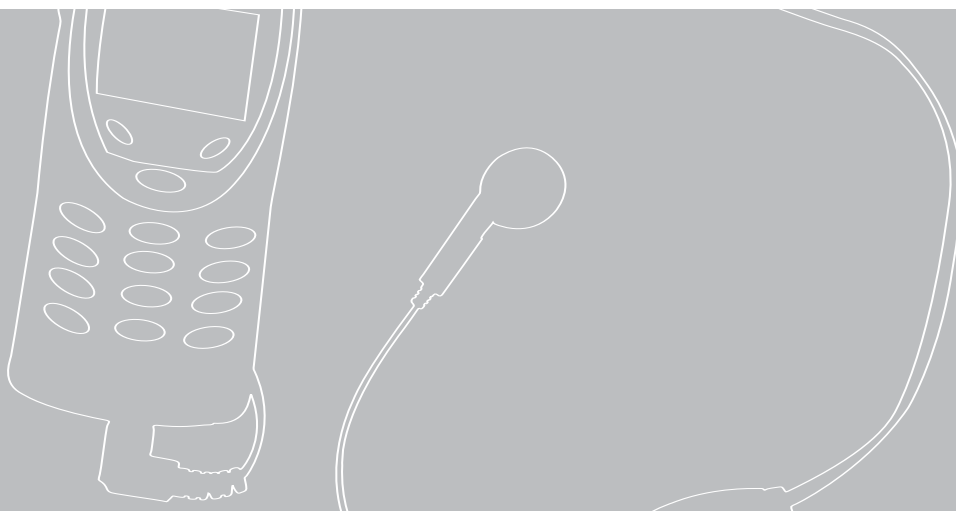
THE FUTURE OF MOBILE MUSIC

In 2005 and beyond, more advanced music applications for mobiles will emerge as a result of the continued roll-out of 3G networks and replacement of handsets. As more content and more services are made available, consumers will become much more familiar with the concept of buying music through their handsets.

Mobile phones are also beginning to see much bigger storage capacity, longer battery life and increased functionality. While current memory capacity on handsets might be small compared to portable players such as the iPod, many expect that 3G mobiles could rival these devices in the future.

"MSN MUSIC, WHICH IS AVAILABLE IN 20 MARKETS, IS A KEY ELEMENT IN MICROSOFT'S VISION OF DELIVERING DIGITAL ENTERTAINMENT TO CONSUMERS AND GIVING THEM THE ABILITY TO EASILY CUSTOMIZE THEIR ENTERTAINMENT EXPERIENCES. MORE THAN ANYTHING ELSE, WE'VE FOUND THAT CONSUMERS WANT TWO THINGS: CHOICE AND SIMPLICITY. THROUGH PARTNERSHIPS WITH MORE THAN 3,000 RECORD LABELS AND MORE THAN 70 DEVICE MAKERS, WE'RE WORKING TO MEET THESE DESIRES BY MAKING IT FUN AND EASY FOR PEOPLE TO FIND THEIR FAVOURITE SONGS AND LISTEN TO THEM ON DEVICES THAT FIT EVERY BUDGET AND LIFESTYLE."

ROB BENNETT, SENIOR DIRECTOR OF MSN ENTERTAINMENT, MICROSOFT



“Digitisation and licensing of music content is a key priority for record companies and essential for the development of the digital music market.”

WHAT DRIVES DIGITAL MUSIC?

Several key factors drive the growth of digital music, including partnerships between record companies and online/mobile music services; growing broadband and mobile penetration; sales of portable players and handsets; rising consumer awareness of legitimate services; the increased flexibility that is offered to the consumer; and the fight against online piracy.

RECORD COMPANY INITIATIVES

Digitisation and licensing of music content is a key priority for record companies and essential for the development of the digital music market. Many record companies have created dedicated digital business units to distribute and market music internationally.

Majors and independent record companies have licensed their music to the big online music brands, including Apple, Napster, Microsoft, OD2, RealNetworks and AOL, as well as to a selection of smaller or niche services. There has also been a big push

in licensing music to mobile operators such as Sprint, Verizon, Vodafone, Orange, T-Mobile and SKT Telecom.

Digitisation has also been a priority. Universal Music, for example, has completed a two-year project to digitise its entire active European music catalogue – some 300,000 tracks drawn from more than 25,000 albums. The company now digitises around 2,500 newly released tracks each week. Universal also launched a digital label in November 2004 – UMe Digital, which will both sign exclusive digital deals with new artists and handle digital distribution deals for independent labels.

Sony BMG has created a dedicated global digital business unit to focus on global digital business development for mobile and online music. The unit also looks at anti-piracy measures, new industry technologies such as CD rights-management software, and new format launches. Sony BMG has also digitised

its entire active catalogue, enabling it to focus on previously unreleased titles. Over 1,600 music videos have already been digitised for electronic distribution.

EMI has signed hundreds of licensing agreements and spent the past few years building its global digital supply chain for both online and mobile services. Digital products can reach world markets day-and-date with its physical releases. EMI has also significantly expanded resources dedicated to digital sales and marketing in key territories. It has offered innovations such as Robbie Williams' memory-card release of the artist's album.

Warner Music has digitised and licensed the majority of its catalogue, signing licensing agreements with a number of online distributors for example, and with Verizon in the mobile sector in the US.

Other specialised digital marketing ventures have launched in 2004. Vital PIA Digital, for example, incorporates dedicated digital

production services, specialised sales and marketing expertise, data management and access to global digital music services for over 50 independent labels.

Record companies are also expanding into new digital channels such as 'music kiosks'. Warner Music and Sanctuary for example, both partnered Mediaport Entertainment Inc. to offer their catalogues in free-standing kiosk units at which people can create compilations and then either burn them to CD or transfer to portable players. EMI partnered with Starbucks in the US to offer the chain's customers the ability to burn custom-made CDs instore.



2004 MARKETING INITIATIVES

Digital only releases

Exclusive artist content available online and via mobile

Release of digital tracks prior to or simultaneously with the release of the single to radio, ahead of physical release

Artist websites offering track downloads and exclusive materials

More information about recordings, such as composers, producers, collaborating performers etc.

Niche download sites, such as Warchildmusic.com and Bignoismusic.com (UK), where a proportion of the price of downloads goes to charity

New digital channels, including 'kiosk services' where consumers can compile their own custom CDs

Specialised campaigns by companies like 7 Digital Media or Recordstore.co.uk who used direct marketing to appeal to a band's fanbase

The launch of digital downloads and ringtone charts in a number of territories

Deals between broadband providers and online music services to offer 'packages' including both services for a single fee (AOL, Tiscali, T-Online)

HARNESSING PEER-TO-PEER (P2P)

The recording industry is working with a range of technologies that create legitimate ways of doing business in online music. It is however, totally opposed to the abuse of technology, and in particular that of certain P2P networks that facilitate large-scale copyright theft. Record companies are now examining the possibilities for using P2P in a legitimate and commercial way that pays rightholders for their works.

There are a number of publicly-disclosed projects underway. Snocap for example, a new venture by original Napster founder Shawn Fanning, provides technology that recognises songs requiring licences on P2P networks and automatically presents users with options to purchase authorised songs instead of allowing unauthorised copies to be traded illegally. A new

service called Mashboxx is reported as being developed with Snocap to offer legitimate, licensed and paid access to content in a P2P environment.

Qtrax and Peer Impact (World Media) are further examples where P2P technology is being designed to facilitate licensed file-sharing with various payment options for users. Companies such as Audible Magic and Overpeer have also developed song-identification systems similar to Snocap. Some of these services plan to launch in early 2005.

Other innovative services include the 'Open Royalty Gateway' developed by Blueprint and supported by BT (UK), launched in November 2004. The system allows for a paid-for 'word of mouth' distribution. Consumers recommend tracks to friends, and are rewarded with credits for future purchases if the tracks are bought.

"SNOCAP IS PLEASED AND PROUD TO HAVE COME UP WITH A TECHNOLOGY PLATFORM THAT WILL BRING THE BREADTH OF MUSIC THAT IS CURRENTLY AVAILABLE ON UNAUTHORISED SERVICES TO THE PAID MARKET PLACE. WE WILL ENABLE P2P SERVICES TO BRING REWARDS FOR EVERYONE CONCERNED – ESPECIALLY FOR THE MUSIC FANS, BUT ALSO FOR ARTISTS, SONGWRITERS AND MAJOR AND INDEPENDENT LABELS ALIKE."
SHAWN FANNING, FOUNDER OF SNOCAP

THE BROADBAND AND MOBILE STIMULUS

Many music markets are seeing rapid growth in broadband penetration rates. Broadband stimulates online music by improving download times and file quality, prompting users to download and burn more regularly. Over 90% of Rhapsody users in the US, for example, have a broadband connection. Forecasts indicate that broadband household connections worldwide will increase by 169% by 2008 (PWC). Latin America will experience the biggest increase (430%).

In most countries broadband penetration is still low at under 20% of households, but rates are on the increase.

Without adequate intellectual property protection, broadband can also have an extremely negative potential – the best example being South Korea, a music market which is dominated by online piracy.

Mobile penetration is also rising at a very fast pace around the world, often surpassing broadband rates, especially in Asia. In Europe mobile penetration exceeds 80% in countries such as Finland, Greece, Italy, Norway,

Sweden and the UK, and is growing rapidly in other markets. The US currently lags behind, but penetration is expected to rise in the coming years.

MULTI-TERRITORY LICENCES FOR ONLINE STREAMING SERVICES

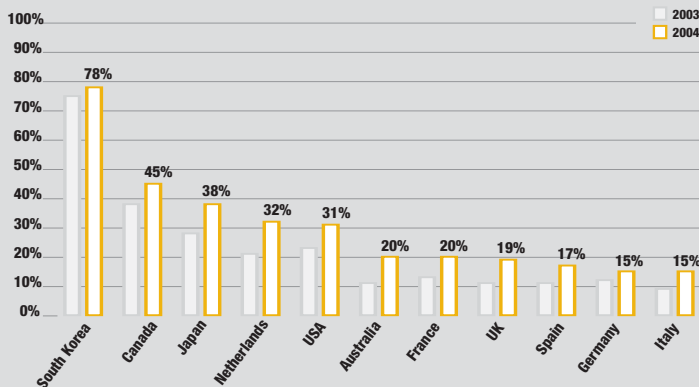
Streaming of music programmes via the internet is just one of the many new forms of digital music distribution. Webcasting is already well-established in the US, where there are currently 1,250 licensed services. International cross-border licensing for internet streaming has been a priority for the recording industry.

IFPI has set up a system that allows internet webcasters and simulcasters to clear the necessary rights in a multitude of countries by entering into a licence in one participating country. Such 'one-stop' licensing facilitates the entire process of setting up legitimate streaming services, eliminating the need for rights to be cleared in each individual country.

In 2004 the IFPI webcasting agreement was extended to include 17 countries, including SoundExchange in the US. Simulcasting of traditional

“WE BELIEVE THAT THE GLOBAL ONLINE MUSIC MARKET IS POISED FOR EVEN GREATER GROWTH IN 2005 AND 2006, AS BROADBAND BECOMES UBIQUITOUS AND CONSUMERS AROUND THE WORLD GROW COMFORTABLE WITH ONLINE SERVICES. REALNETWORKS WILL CONTINUE TO WORK CLOSELY WITH THE GLOBAL MUSIC INDUSTRY TO DELIVER LOCALISED ONLINE SERVICES THAT MAKE IT EASY FOR MUSIC FANS TO EXPLORE AND ENJOY THE MUSIC THEY LOVE.”
 ROB GLASER, CHAIRMAN & CEO OF REALNETWORKS (RHAPSODY)

BROADBAND HOUSEHOLD PENETRATION



Source: Understanding & Solutions



broadcasters' programming onto the internet is now facilitated by a similar cross-border agreement among producers' rights societies in 35 countries.

PORTABLE MUSIC BOOSTS DEMAND

The trend towards portable technology is phenomenal. Portable players like Apple's iPod have given consumers greater control and portability of their music collections. The growing popularity of digital players, which themselves have intrinsic consumer appeal, is driving the uptake of legal music services.

The global portable digital player market was estimated to be worth US\$4.4 billion in 2003 and is estimated to rise to US\$7 billion in 2004 (IDC).

The portable player market already presents consumers with an array of choices. Apple now has a wide range of competitors including Creative (Zen product range), Rio (Karma, Carbon), Sony (Network Walkman) and others. To date

the iPod, with over 50% share of the global market (including both flash media and hard-drive based players, IDC), has been the most successful portable digital player, reaching sales of 10 million units since launch in 2001. In October 2004 Apple launched the first artist-branded digital player, the U2 iPod, which included a discount on the option to purchase U2's entire catalogue through iTunes.

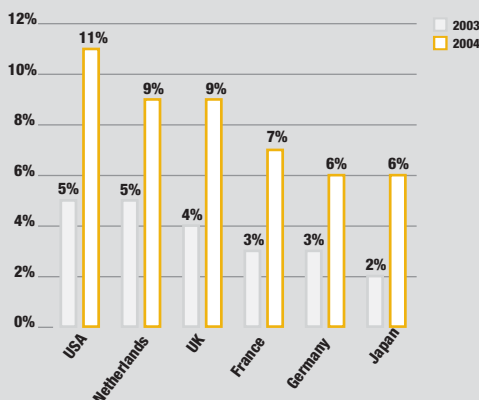
The market is beginning to see a convergence of portable music devices and mobile handsets, although small memory capacity and limited battery life place limits on this convergence for the time being. Many consumer technology companies, including Apple and Microsoft, are partnering mobile handset makers to offer compatible services for download or streaming to phones.

The rapid rise of different portable player systems has exposed one key problem, namely the lack of interoperability between different devices and services.

The major consumer technology companies behind the development of the major online services – namely Apple, Microsoft, Sony and RealNetworks – have developed their hardware and software using preferred or proprietary technologies. The Apple iTunes service, for example, is only currently compatible with the Apple iPod. Microsoft technologies have been used by a number of leading online services and a number of different manufacturers produce players compatible with those services, although they are still incompatible with, for example, technologies by Apple, RealNetworks and Sony. Sony Connect offers songs in Sony's ATRAC3 format, compatible only with Sony players.

Interoperability barriers between the various suppliers' products and services are confusing to consumers and ultimately could place limits on the growth of the sector. Achieving interoperability between different music services and devices is therefore a top priority both for the consumer and for the recording industry.

GROWTH OF PORTABLE DIGITAL PLAYER PENETRATION



Source: Understanding & Solutions. Figures exclude CD and MiniDisc players

PORTABLE PLAYER EXPLOSION – SOME KEY STATISTICS

75% of portable player owners said that they listened to music they 'most likely would not have done otherwise' – Harris Interactive (for Guardian Unlimited), UK

16% of consumers who had paid for downloads owned iPods – Entertainment Media Research (May 2004, sample of 540 internet users), UK

Nearly 50% of Rhapsody customers in the US own portable digital players – RealNetworks

Sales of iPod have reached 10 million units since launch in 2001 – Apple

CONSUMER AWARENESS AND UPTAKE IMPROVES

A growing number of consumers are paying for music downloads, more intend to do so in the future and awareness of legal services is rising sharply, according to research by IFPI as well as by third parties.

In the US, internet music users paying for downloads more than doubled to 35% in the year to July 2004, according to IPSOS. In the UK, 23% of downloaders said they had paid to do so at some stage (Entertainment Media Research 2004).

IFPI research indicates that the number of people buying music online legitimately appears to be rising fast – even though fewer than one person in ten in Europe regularly downloads music. A survey conducted in six European countries (Austria, Denmark, France, Germany, Italy and the UK) by GfK for IFPI in December 2004 shows that while some 44% of music downloaders used a P2P service during November 2004,

a further 44% actually downloaded from either a legal service (22%) or an artist/band website (also 22%). Although legal download volumes are still low compared with P2P, the survey indicates that the number of people using legal sources is fast approaching those using P2P.

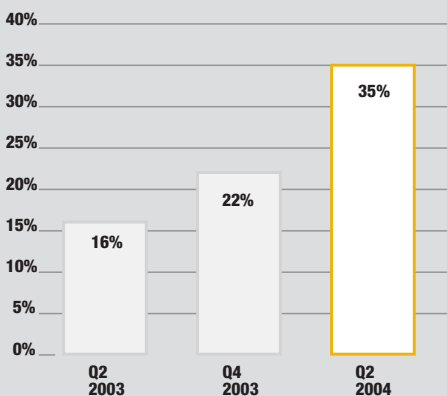
The same survey also indicates that use of legal services is likely to increase significantly in 2005. Of those who intend to download music in the next few months, almost one third (31%) stated that they are likely to download from a legal service (compared to the current level of 22%). Meanwhile, P2P use is not expected to grow, with some 38% of those intending to download saying that they are most likely to use a P2P service, compared to the current level of 44%.

Awareness of the existence of legal online music services has grown, with 29% of Europeans aware of legal online services in December 2004 (49% of 16–29 year olds), up from only 23% of Europeans (38% of 16–29 year olds) in December 2003.

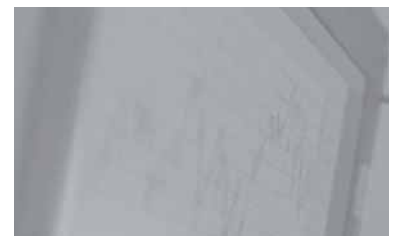
A key element of the record industry strategy is to move illegal file-sharers over to the legitimate paid-for services. For existing online music users, there appears to be a clear divide between users of legal services and people downloading illegally using a file-sharing service. In the US, NPD Group research, which monitors household downloads, shows that just 9% of households regularly use both legal services and file-sharing networks – it tends to be one or the other.

Younger consumers (under 25s) seem more reluctant to try legal alternatives. However this is changing rapidly, thanks in part to increased ease of payment. Napster has introduced pre-pay cards in the US and in the UK, available widely from retail stores, and iTunes has introduced the use of PayPal to allow users to pay for downloads without using a credit card. The vast majority of legal online services now offer gift certificates or alternative payment schemes to credit cards.

GROWTH IN PAID-FOR DIGITAL MUSIC SALES IN THE US



Source: IPSOS TEMPO.
Proportion of consumers downloading who have paid for music during the previous three months.



WHY LEGAL SHOPS ARE BETTER THAN ILLEGAL FILE-SHARING

They ensure payment to the creative community and guarantee future investment in music

They are virus and spyware free

They offer a better interface with portable music players for seamless management of music collections

They offer exclusive tracks often weeks before general release, or exclusive to the services that offer them

File quality is guaranteed

They offer quality editorial including reviews, recommendations and personalised radio stations

They are wholeheartedly supported by artists

FLEXIBLE LISTENING

The combination of searching, browsing, downloading and portability is transforming the experience of consuming music. Notably, it is driving demand for single tracks.

In the physical audio market, singles make up roughly 10% of unit sales compared to 90% for albums. So far, online music consumption shows an almost inverse pattern to this, with iTunes, for example, reporting that roughly only one in ten transactions are a full album purchase.

While this suggests a long-term shift in music consumption from albums to singles as digital sales increase share of consumption, the increase in digital single tracks could easily compensate for this shift. Already in the US, download sales outnumber physical singles by just under 20 to 1.

Digital download sales are likely to stimulate singles sales overall. In the UK the industry estimated that downloads alone would have turned a fall in singles sales of 14% in 2004, into an increase of 4%.

Record companies have responded proactively to these changes, presenting digital music in many different forms. By offering high quality audio, video, graphics and data specifically tailored to individual requirements, digital music stores can offer a much wider variety of music-related media than record stores in the physical world.

At the same time, record companies have also been enhancing the physical CD – offering special edition releases and value-added content helping sustain demand for CDs in the future.

In the longer term, digital consumption is expected to replace CD buying to some extent, since many younger music fans see their 'record collections' as digital files. Moreover, the convenience of digital is attracting new music consumers. However many people, including online music consumers, still prefer CDs for their packaging and artwork.



THE COMPLEXITIES OF SETTING UP A LEGITIMATE SERVICE

Digitising content

Rights-clearance and artist negotiations

Robust technologies

Consumer-friendly DRM and 'usage rules'

Virus free services

Secure payment systems

"GERA-EUROPE SUPPORTS THE STEPS THE MUSIC INDUSTRY IS TAKING TO ENCOURAGE THE FAST-DEVELOPING LEGITIMATE ONLINE MUSIC BUSINESS – THE EDUCATIONAL PROGRAMMES IN WHICH WE HAVE BEEN INVOLVED; THE PUBLIC PROMOTION OF ALL THE NEW ONLINE SERVICES; AND THE DECISIVE ENFORCEMENT OF THE INDUSTRY'S RIGHTS AGAINST ILLEGAL UPLOADERS." SIMON WRIGHT, PRESIDENT OF GERA-EUROPE (GLOBAL ENTERTAINMENT RETAIL ASSOCIATION) AND CHIEF EXECUTIVE OF VIRGIN ENTERTAINMENT GROUP INTERNATIONAL

KEY ONLINE SERVICE PROFILES

	COMPANY PROFILE	LAUNCH	REACH
 <p>www.apple.com</p>	<p>Apple released the first iPod in October 2001. The iTunes Music Store followed in April 2003 and both have been a phenomenal success, helping to increase the company's revenues by 33% year-to-September 2004. The iPod, which accounted for 23% of the company's sales in Q3 2004, has strengthened the Apple brand and created a 'halo-effect' on consumers, encouraging a whole economy of peripheral products</p>	<p>First launched in the US in April 2003 and expanded into three key European markets – UK, France, Germany – in June 2004. Further launches in Europe were announced in October, followed by the Canadian launch in December. The service is expected to reach Japan in 2005</p>	<p>15 countries</p>
 <p>www.msn.com</p>	<p>Microsoft's MSN Music is driven by OD2 technology in the main European markets and by cdon.com in Scandinavia. In the US, the service was fully developed by Microsoft</p>	<p>Reached the US, UK, France, Germany, Netherlands, Japan and Italy in October 2004. Further European launches took place in November</p>	<p>20 countries</p>
 <p>www.napster.com</p>	<p>Created by Shawn Fanning in 1999, Napster became world-famous for being the pioneering file-sharing network. The service was closed down in July 2001 and acquired by Roxio in November 2002. Napster 2.0 emerged in October 2003 in the US as a legitimate online service</p>	<p>Napster 2.0 launched in the US in October 2003, and in UK and Canada in May 2004</p>	<p>US, Canada, UK</p>
 <p>www.connect.com</p>	<p>Launched by Sony</p>	<p>The service was first launched in the US in April 2004 and expanded into Europe in July. Plans further European expansion during 2005</p>	<p>US, UK, Germany and France</p>
 <p>www.rhapsody.com</p>	<p>Listen.com was the first independent service to offer content from all five majors, launching Rhapsody just before MusicNet and Pressplay. In April 2003 RealNetworks bought Listen.com and consequently Rhapsody, which started using RealNetworks technology as its primary platform. A month after Real's acquisition, RealOne Rhapsody Music Subscription was launched</p>	<p>Originally launched in December 2001. Re-launched in May 2003</p>	<p>US only. Launching in the UK and Europe in 2005</p>
 <p>www.virgindigital.com</p>	<p>Service launched by the Virgin Group following the partnership between Virgin Digital and MusicNet</p>	<p>September 2004</p>	<p>US only</p>

BUSINESS MODEL	MAIN PARTNERSHIP DEALS	CATALOGUE	SALES TO DATE	PORTABILITY	UNIQUE FEATURES
A la carte downloads	Partnerships announced with Motorola and Hewlett-Packard	Between one million and 700,000 songs depending on the territory	230 million by January 2005	iPods	Over 150 exclusive tracks, share playlists (iMix), stream music wirelessly to remote stereos (iPort Express), weekly free single (New Music Tuesdays), 9,000 audio books, email alerts on favourite artists (Artist Alerts)
A la carte downloads	Deal with GarageBand.com offers highlights of music and content from the community's top-rated independent artists (GarageBand.com Hub Page). MSN also has a promotional tie-in with American Express	Over one million songs	Not available	Multiple Windows Media Audio-enabled devices, including Creative Zen, Rio and iRiver	Exclusive tracks, search on which cities produced the most influential artists by decade (Map of Music), streams music videos, concert tickets
Subscription (unlimited streaming) and a la carte	AT&T Wireless will allow Napster subscribers to transfer songs to a mobile phone (Audiovox SMT 5600 smart phone). The mobile phone will be sold by Orange in the UK (Napster To Go). Tie-in with Blockbuster launched the Digital Duo card in the US for sale for US\$ 20 for one month's subscription and Blockbuster Online DVD rental	Over one million songs	270,000 paying subscribers as at December 2004	Multiple Windows Media Audio-enabled devices, including the Samsung Napster Player, Creative Zen, Rio and iRiver	View other subscribers' music library (Napster Community), recommend songs to other subscribers, portability with subscription plan (Napster To Go), access to service on up to three computers, email track suggestions to friends (Napster Inbox)
A la carte downloads	Promotional tie-ins with United Airlines and Intel	650,000 songs	Not available	Sony portable devices	Exclusive performances (Connect Sets), mood-specific playlists (Mood Mix)
Subscription (unlimited streaming) and a la carte	Rhapsody has partnerships with Comcast (broadband provider) and BestBuy	850,000 songs available for streaming and over 750,000 available for purchase. More than 90% of the available tracks are streamed at least once each month	625,000 paying subscribers at the end of Q3 2004 (Rhapsody & RealOne RadioPass) representing a growth of 145% on Q3 2003. The average paying subscriber streams more than 250 songs each month, the equivalent of more than 25 CDs	N/A	Radio customisation, access to service on multiple computers, send playlists to other subscribers via email, add playlist links to personal 'blogs'
Subscription (Virgin Digital Music Club) and a la carte (Virtual Virgin Megastore)	Foot Locker promotional deal	Over one million songs for streaming and purchase	Not available	Multiple Windows Media Audio-enabled devices, including Creative Zen, Rio and iRiver	Service is available via the internet, in retail stores, on mobile phones and consumer electronic devices, music discovery function (Ask The Expert), detailed artist/album information (3-D Browsing)

THE INDUSTRY TAKES ON DIGITAL PIRACY

“2004 was the year the music industry stepped up its fight-back against online piracy around the world. These activities are having an impact.”

2004 was the year the music industry stepped up its fight-back against online piracy around the world. Seven countries joined the US in taking legal action against individuals illegally uploading files on peer-to-peer (P2P) networks. Information and awareness campaigns were stepped up, as were instant messaging to P2P users and deals with universities.

These activities are having an impact. Consumer awareness of the illegality of unauthorised file-sharing across Europe has improved. Trends in illegal file-sharing show the problem is being contained, helped by the growing availability of legal music downloads.

WHAT IS INTERNET PIRACY?

Internet piracy is the act of making available, transmitting or copying someone else's work over the internet without permission. Copyright laws in virtually every country in the world make this illegal, protecting the rights of those involved in creating and those investing in creative works – writers, publishers, artists, musicians, record companies, film makers, producers, and many others. These laws acknowledge their right to choose how their work is distributed and the terms of distribution.

Authorisation by the rights owner is the fundamental principle underlying copyright laws, and the key to the distinction between legitimate and illegal online music distribution. Legitimate online services have permission from record labels, publishers and artists whose music they distribute. They pay these people for the use of their works in commercial activities. Online piracy involves people or services who distribute music without authorisation.

ILLEGAL FILE-SHARING AND ITS IMPACT

Numerous research studies show that online piracy has a negative impact on legitimate

sales of music. While other factors also affect music sales, including competition from other consumer products and general economic conditions, online piracy has contributed substantially to sales drops in recent years.

Global music industry sales declined by some 22% over five years to 2003, a reduction of over US\$6 billion, with some of the biggest drops in album and singles sales in countries with large or growing broadband penetration. The latest study by Forrester Research in August 2004, found that while 10% of regular downloaders claimed to buy more music, 36% admitted

SERVICE TYPE	DESCRIPTION	WHAT IS WRONG WITH IT?
WEB, FILE TRANSFER PROTOCOL (FTP) AND LINK SITES	This 'traditional' form of online piracy remains popular in many countries. Typically the first place where unauthorised copies of a new recording appear.	These services do not attempt to obtain licences for the use of copyrighted music. Although they may not profit directly from the distribution of music, they often generate advertising revenues and user traffic – effectively profiteering out of those who created and invested in music.
UNAUTHORISED SERVICES	These are blatantly commercial services, generating substantial revenues from unauthorised use of music and other copyrighted content. Some services sell music directly, others receive indirect revenues from advertising, spyware and licensing. In many cases such services operate with large databases of music tracks.	Because these services do not reward those who created and invested in music, operating costs are low and financial gains can be substantial. P2P networks encourage and assist the distribution of a large number of music files between individual users ('peers') without the rightholders' permission.
ILLEGAL UPLOADERS	Most users of P2P networks not only download files, but make the music stored in their computer available to others to download, thus acting as 'uploaders'. This turns individual users into large-scale distributors of unauthorised files.	P2P uploaders do not have permission to distribute music files, hence engaging in an illegal activity.



“WE MUST FIGHT PIRACY IN ANY FORM, FOR THE PROTECTION OF INTELLECTUAL PROPERTY IS IN ALL OUR INTERESTS. IT GIVES ECONOMIC VALUE TO THE MOST PRECIOUS THING, CREATIVITY, WHICH IS THE GROUNDS OF OUR FREE SOCIETY.”

CARLO AZEGLIO CIAMPI, PRESIDENT OF ITALY

to buying less. This result has been confirmed repeatedly in the bulk of all respectable third-party research.

THE INDUSTRY'S RESPONSE

The recording industry is developing legitimate online music services that will displace illegal sites over time, using education, and, if necessary, law enforcement to protect its repertoire.

1. PUBLIC AWARENESS AND INFORMATION CAMPAIGNS

Public awareness plays a critical part in introducing legal alternatives and educating consumers on risks attached

to online piracy. In 2004 the music industry stepped up its educational activities to point people away from illegal file-sharing and towards legal download sites.

Schools

In Italy, a government-backed music, film and software copyright education programme has been launched to explain copyright to 14 to 18 year-olds in 3,000 schools. In France, a two-page copyright and anti-piracy message has been sent to one million students. In Germany, a music industry and 'Value of Creativity' campaign provides educational materials to 10,000 teachers of 10 to 15 year-olds. In the UK, a 'Respect

the Value of Music' school curriculum for 11 to 14 year-olds, developed by British Music Rights, directs students to www.pro-music.org for legal downloads. A new campaign was launched in Japan in December 2004, with public statements by four major artists.

Parents and children

The Danish music industry launched a free software programme that people can use to identify and, if necessary, remove unauthorised P2P programmes and files from their computers.

Universities

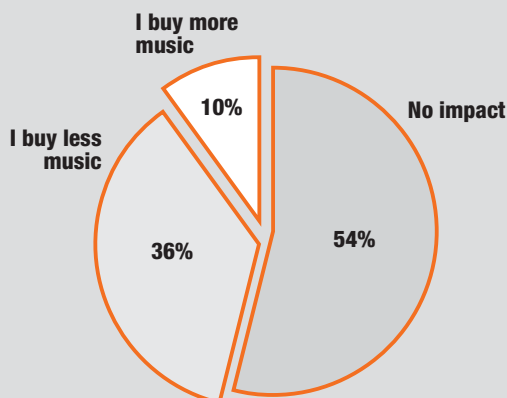
In the US, cooperation between legal online services and record

companies led to legitimate services being made available at discount to students in 24 colleges and universities. The scheme was pioneered at Pennsylvania State University in a deal with Napster, and was followed by further deals with Rhapsody at other universities. US universities have also been using anti-piracy technical countermeasures against illegal P2P file-sharing (www.educause.edu).

Companies

IFPI and its affiliates have conducted an information campaign on the copyright and security risks involved in illegal P2P file-sharing, among thousands of companies

IMPACT OF ILLEGAL DOWNLOADING ON MUSIC PURCHASING



Source: Forrester Research, August 2004. Base: European online consumers who downloaded music monthly

THE IMPACT OF ILLEGAL FILESHARING

28% of those spending less on music said downloading, file-sharing and burning were the main reasons – Pollara Canada, July 2004

For 2004, the potential losses to the music industry through file-sharing could be as high as US\$2.1 billion – Informa Media Group

36 million of the 40 million people downloading (nine in ten) in Europe are still not paying for music they download – Forrester, August 2004

“PIRACY IS THEFT – PURE AND SIMPLE. THE GOVERNMENT SUPPORTS THE PRINCIPLE OF PROPORTIONATE LEGAL ACTION AGAINST THE WORST OFFENDING UPLOADERS.”

ESTELLE MORRIS, ARTS MINISTER, UK

and government institutions in 21 countries. Brochures explain that these institutions are at risk of legal action if music is used illegally on their computers and that unauthorised file-sharing raises a host of security problems for institutional networks including computer viruses, firewall breaches, spyware, and exposure of confidential data. The brochures, which also explain how to tackle the risks, can be downloaded in six languages at www.ifpi.org.



Instant messages to infringing file-sharers

IFPI national groups in 10 countries have sent more than 45 million instant messages to individual users of P2P services, warning them to stop putting other people's music on the internet without permission.

The pro-music campaign

The international cross-sector music campaign, www.pro-music.org, launched in 2003, is now available in four languages (English, French, German, Italian) and includes a global directory of legitimate online services. The mission of pro-music is to promote legitimate digital music and confront the myths surrounding online music piracy.

Internet advertising

French-initiated pro-music viral email "The Drummer" was rolled out across Europe, calling on downloaders to protect those involved in creating music by downloading legally.

Artist campaigns

In the US, artists including Lenny Kravitz, Missy Elliot and Sheryl Crow featured in an 'I Download (Legally)' campaign. A similar project was rolled out in France in a poster campaign with 14 artists in 30 cities.

WHY NOT TO DOWNLOAD ILLEGALLY

Your computer may crash

Peer-to-peer (P2P) programs write files to your hard disc and change your computer settings. These can be nearly impossible to remove and may crash your computer if you try

You can catch a computer virus

There is no quality control on the files that other people put on unlicensed P2P services. A 2004 study by security firm TruSecure found that 45% of the computer programs downloaded using Kazaa contained a virus or other malicious code

You will get adware and pop-ups by default

Unlicensed P2P services make their money by selling advertising. The advertising comes to you via software they put on your machine – sometimes without you knowing

You may get spyware without knowing it

In many cases, the software that unlicensed P2P services distribute also contains modules that report on your file searching, web browsing or other activity. Among other things, it helps them send advertising to you

You will come across unsolicited pornographic material

Search for any popular artist's music on an unlicensed P2P service and you will also get lists of files that include a whole range of pornographic and obscene material

You will open up your computer to complete strangers

Unlicensed P2P file-sharing involves giving millions of anonymous strangers access to your computer

You could be sued

Over 7,000 cases have been brought against bulk uploaders in several countries worldwide

"WE HAVE TO TAKE RESPONSIBILITY, CALL PIRACY WHAT IT IS AND NOT ALLOW IT TO BE CONFUSED WITH 'UNLIMITED FREEDOM'. I BELIEVE IN CULTURAL CREATION AND DIVERSITY, WHICH ARE THE VICTIMS OF PIRACY. THEY NEED TO BE PROTECTED."

RENAUD DONNEDIEU DE VABRES,
MINISTER OF COMMUNICATION, FRANCE

2. DETERRENCE

In 2004 IFPI and its member record companies significantly stepped up the deterrence campaign against internet piracy. Cooperative work with Internet Service Providers (ISPs), litigation cases against infringing services, as well as cases against individual illegal uploaders, are all part of this strategy.

High-volume notice and takedown

Notifications are sent to ISPs, universities and companies when users are found using their systems to offer unauthorised music on the internet. ISPs are often cooperative in removing infringing web, FTP and links sites when they receive such notice. In many cases, they will also block access to P2P servers running on individuals' computers, or block pre-release music files being offered from an individual's computer. The ISPs' own terms of service typically prohibit individual users from engaging in such activities.

In 2004 IFPI's internet anti-piracy unit and anti-piracy staff in 28 national recording industry groups, secured the take-down of 60,900 infringing websites (41,000 in 2003), 477 unauthorised P2P servers (1,050 in 2003) and 1.6 billion infringing music files in 102 countries (1.6 billion in 2003).

High-profile litigation against sites and services

Where cooperation does not work, the industry pursues strategic court cases against internet sites and services that build their business on music that has not been paid for. The industry's main litigation strategy has been to stop infringement at the level of the services through which the majority of unauthorised music files are available. The bulk of the traffic on P2P networks is driven by a relatively small number of uploaders – 75% of all distribution is accounted for by 15% of all individuals (NPD 2003).

RECENT CASES HAVE INVOLVED CLAIMS AGAINST:

Companies and principals related to the Kazaa P2P service (Australia)

This case, which went to trial in November 2004, alleges that the defendants violated copyright and authorised others to do so. At time of print, the judge was preparing his decision in the case.

Japan MMO

This P2P service operator was found guilty of infringement and ordered to pay ¥36.9 million (US\$350,000) plus interest as compensation. The court also issued an injunction against the service.

Kuro, EzPeer (Taiwan)

Taiwan courts have enjoined these subscription P2P services from offering 105 infringing tracks. Civil and criminal proceedings continue.

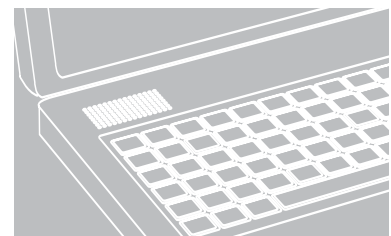
Weblisten (Spain)

All six civil plaintiffs have secured injunctions against this site in cases claiming that the site offered streams and downloads without licences from the record labels. Appeals and enforcement are pending.

Legal cases against individuals engaged in 'uploading'

In 2004 it became clear that, however effective education programmes were in raising awareness, stronger action was needed to deter a significant group of 'hard core' illegal uploaders. The industry needed to show that uploaders of copyrighted music are not only breaking the law, but can be caught and made accountable. In 2000, an initial 700 legal cases were launched against bulk uploaders of music in Austria, Canada, Denmark, France, Germany, Italy and UK. In addition, more than 6,000 cases have been brought to date in the US, which started bringing lawsuits in 2003.

In most of the countries involved, there has been a regular flow of settlements averaging a few thousand euros. In Austria, around 50 cases were settled within three months, the highest compensation payment being EUR4,000. In Denmark and Germany, over 100 cases have been settled, with the highest individual payment of EUR13,000.



“WE KNOW THAT THERE ARE MILLIONS OF ILLEGAL FILES CIRCULATING ON THE INTERNET AT ANY GIVEN TIME. IN THE EUROPEAN PARLIAMENT WE HAVE DEALT WITH THIS BY PASSING EFFECTIVE LAWS TO LEGISLATE FOR THE INTERNET AGE. THERE IS NO UPSIDE TO ILLEGAL UPLOADING – IT UNDERMINES JOBS AND CREATIVITY. THE LAW IS THERE TO BE RESPECTED AND ENFORCED.”

ARLENE MCCARTHY, MEMBER OF THE EUROPEAN PARLIAMENT

WHY FIGHT THE BATTLE?

The aim of the record industry’s educational and anti-piracy actions is to help create a breathing space for the burgeoning online music market, to raise awareness, change attitudes and contain illegal file-sharing. Their impact in 2004 has been visible.

INCREASING PUBLIC AWARENESS ABOUT ILLEGAL FILE-SHARING

Seven out of ten people surveyed in North America and Europe are now aware that unauthorised file-sharing is illegal. Before the recording industry began its public education initiatives and anti-piracy actions against unauthorised file-sharing, this figure stood at only 37%.

CONTAINING ILLEGAL FILE-SHARING

Online music piracy has proliferated dramatically in recent years, but is being contained in the context of the dramatic increases in broadband coverage of the last two years, and rising levels of film and video piracy.

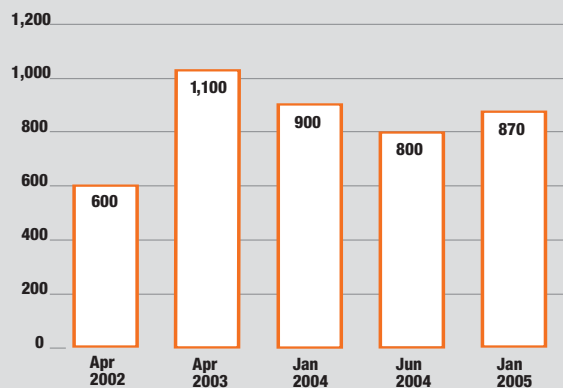
In the five years up to 2004, the number of infringing music files on the internet soared from 1 million to 1.1 billion. The problem has been largely contained since early 2003, when plans to act against illegal file-sharing were first announced in the US and the first raft of legitimate online services were rolled out for consumers.

Measuring online piracy is an inexact business and often confused by the competing claims and methodologies of countless research firms. Methodologies range from counting website hits to software downloads, traffic and request data, and user sampling.

IFPI has consistently measured the number of unauthorised music files offered at any one time. This is based on the number of users per service, the average number of files per user, and the average percentage of music files versus the other files offered by users.

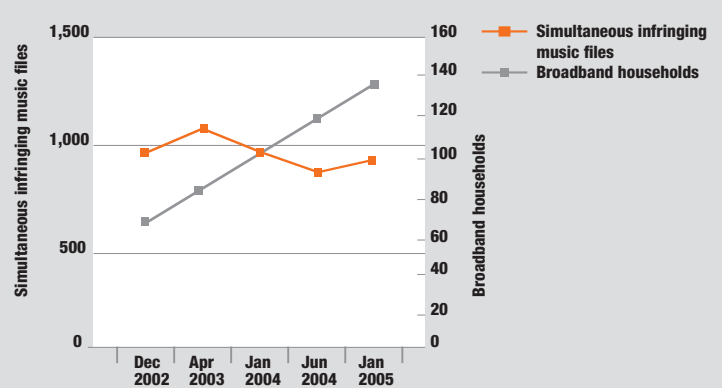
IFPI estimates show that pirate music online has not grown since 2004 despite a massive increase in broadband

INFRINGING MUSIC FILES ON THE INTERNET (MILLIONS)



Source: IFPI, includes P2P networks and Web and FTP sites

IFPI INTERNET PIRACY TRACKING (MILLIONS)



Source: IFPI and broadband data from PWC



usage across the music industry's most key markets. In January 2005 there are around 870 million infringing music files on the internet at any one time (about 90% of them are on P2P networks, the remainder on FTP and websites). This is down slightly from 900 million in January 2004 (and sharply down from 1.1 billion in April 2003).

Notable trends are the decline in use of the largest service Kazaa, the rise in file-sharing of films and video and the increase in illegal file-sharing activity on new services where there has up until now been less enforcement. This led to a slight increase in the overall estimated numbers of infringing music files in the second half of 2004, from 800 million to 870 million files.

Indeed with the migration from Kazaa, use of other peer-to-peer services (notably eDonkey, Gnutella, DirectConnect and BitTorrent) rose in 2004. However, user numbers on those services increased more sharply than the number of infringing music files; this appears to be largely accounted for by a big rise in file-sharing of

non-music files, such as film, video and software. Music files represent a smaller proportion of the newer services – an estimated 25% of files on eDonkey are music, for example, as opposed to an estimated 75% on Kazaa.

STEPPING UP DETERRENCE IN 2005

Legal actions against illegal file-sharing will be stepped up in an increasing number of countries in 2005. Lawsuits, which up until now have been largely focused on users of Kazaa, will increasingly target different networks, despite those services' devious techniques to avoid liability. These include pushing various technical functions to other users, encrypting communications, using third parties' internet accounts, moving infringing files off-shore, and disguising their identities through various technical means.

INTERNET PIRACY: THE KEY STATISTICS

870 million unauthorised music files on the internet (all services), January 2005 (down from 900 million in January 2004)

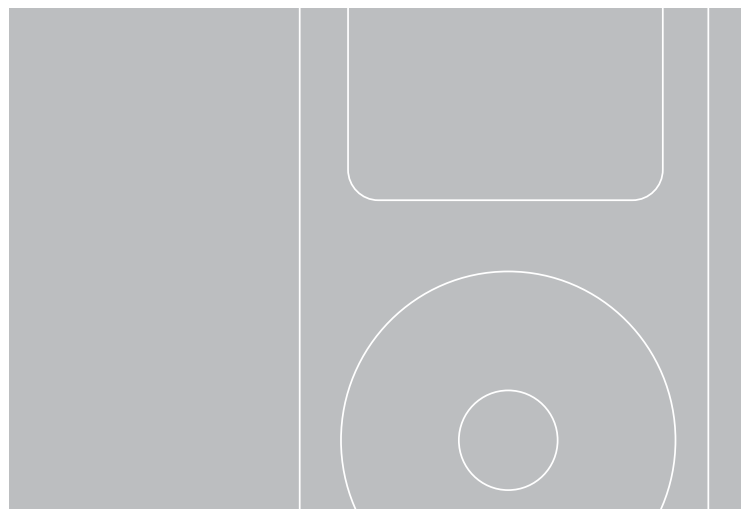
8.6 million concurrent users on P2P networks offering unauthorised music files as of January 2005 (6.2 million in January 2004), but with a big rise in film and video files available

2.3 million concurrent users on Kazaa and its related services (3.2 million in January 2004)

150,000 infringing web/FTP music sites on the internet in January 2005 (25% less than in January 2004)

ILLEGAL MUSIC FILES ON THE INTERNET (MILLIONS)

	APRIL 2002	APRIL 2003	JANUARY 2004	JUNE 2004	JANUARY 2005
WEB & FTP SITES	100	100	100	100	110
P2P NETWORKS	500	1,000	800	700	760
TOTAL	600	1,100	900	800	870

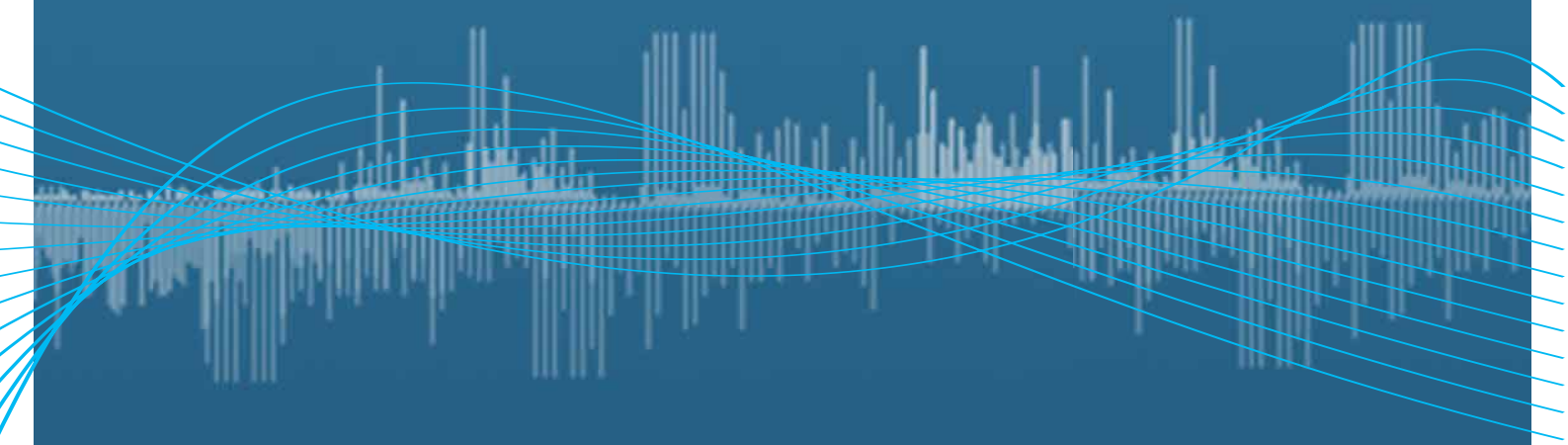


“ILLEGAL COPYING PREVENTS CREATIVE PEOPLE
MAKING A LIVING FROM THEIR ART.”

BRIAN MIKKELSEN, MINISTER OF CULTURE, DENMARK

IFPI Secretariat
54 Regent Street
London
W1B 5RE
United Kingdom

Tel: +44 (0)20 7878 7900
Fax: +44 (0)20 7878 7950
Email: info@ifpi.org
www.ifpi.org
www.pro-music.org



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Designed by [elliottyoung](http://elliottyoung.com) +44 (0)1932 842 711



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