



## iTunes: Some Observations After 500 Million Downloaded Songs

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### I. Introduction

A few months after the launch of Apple's iTunes Online Music Store (iTMS) in the United States, the Digital Media Project at the Berkman Center for Internet & Society at Harvard Law School presented a case study of what has been described as the "pacesetter"<sup>1</sup> in the emerging online music market.<sup>2</sup> The report was aimed at gaining an advanced knowledge of the relationships among copyright law, contract law, digital rights management schemes, and business modeling processes in the Post-Napster world. Further, the case study expanded the knowledge base of the Digital Media Project beyond U.S. law by covering legal and regulatory frameworks of other countries. A follow-up report was released in June 2004 after Apple announced the launch of its iTMS in the U.K., France, and Germany. The second paper provided a tentative analysis of iTunes Europe against the backdrop of distinct legal and regulatory frameworks on the other side of the Atlantic.<sup>3</sup> In the meantime, Apple's iTunes Music Store has extended its reach, currently having stores in 20 countries<sup>4</sup> selling more than 500 million songs worldwide—most recently, Apple has launched iTunes Music Store in Japan.<sup>5</sup> Despite strong competition by subscription services such as RealNetwork's Rhapsody and Yahoo! Unlimited, but also by persisting P2P file-sharing,<sup>6</sup> iTMS has kept a leading role in the online music business with estimated market shares over 80 percent.<sup>7</sup>

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<sup>1</sup> In fact, iTMS was not only the "pacesetter", but a key player who broke the ice. While music industry players were hesitant to make music content available on the Internet, a hardware and software manufacturer company got into the digital music world and created the online music market.

<sup>2</sup> Berkman Center, *iTunes: How Copyright, Contract, and Technology Shape the Business of Digital Media*, June 2004, available at <http://cyber.law.harvard.edu/media/uploads/81/iTunesWhitePaper0604.pdf>.

<sup>3</sup> See Berkman Center, *iTunes Europe: A Preliminary Analysis*, June 2004, available at [http://cyber.law.harvard.edu/media/uploads/82/itunes\\_europe\\_analysis.pdf](http://cyber.law.harvard.edu/media/uploads/82/itunes_europe_analysis.pdf).

<sup>4</sup> <http://www.apple.com/itunes/500million/>.

<sup>5</sup> <http://www.apple.com/pr/library/2005/aug/04itms.html>.

<sup>6</sup> See, e.g., <http://news.cnet.co.uk/digitalmusic/0,39029666,39190360,00.htm>.

<sup>7</sup> Information regarding Apple's financial results in the third quarter of 2005 is available at <http://www.apple.com/quicktime/qtv/earningsq305/>.

This document takes yet another look at the iTunes Music Store. In contrast to previous studies, however, it does not intend to provide a thorough follow-up analysis of the specific interactions between markets, technology, norms, and the law, nor does it seek to describe the Post-Grokster digital music landscape in greater detail.<sup>8</sup> Rather, it seeks to share some observations that one might find interesting from a business, legal, or policy perspective.

The subsequent section focuses on market and business issues that seem noteworthy, while section III deals with legal phenomena such as contractual issues and fair use that have evolved while Apple's iTunes has expanded to new markets. The fourth section points to some interesting developments on the policy level—some of them emerging in the aftermath of iTunes' going global. Comments on this paper, intended as a working document, are encouraged and appreciated.

## II. Expanding Markets – Evolving Offers

As noted above, iTunes is currently present in 20 countries. Most recently, iTunes launched in Japan after difficult rights negotiations that delayed its debut, and earlier this year in Denmark, Norway, Sweden, and Switzerland. The online Music Store features songs from all major music companies and over 1,000 independent record labels. Through iTunes, more than half a billion songs have been sold worldwide since its launch in April 2003; 50 million songs have been sold over the Pan-European iTunes launched in October 2004<sup>9</sup> and one million songs in the first four days after Japanese iTunes's launch.<sup>10</sup> Paid downloads more generally are beginning to represent a substantial portion of the overall revenues of the music industry. In the first six months of 2005, 180 million single tracks were downloaded legally according to IFPI, compared to 57 million tracks in the first half of 2004 and 157 million for the whole of last year.<sup>11</sup> According to a recent report by the IFPI, record companies and market observers expect that the legitimate digital market could account for up to 25 percent of total sales within five years.<sup>12</sup> However, legitimate online music services also have to compete against free file-sharing services.<sup>13</sup> Viewed from that angle, success is not only defined in absolute numbers, but also as a ratio between songs purchased via authorized music sources versus music downloaded via P2P file-sharing networks. A recent study declares iTunes more popular than most P2P file-sharing services.<sup>14</sup> The accurateness of the results presented in study, however, remains highly questionable due to methodological problems, as several observers have pointed out.<sup>15</sup>

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<sup>8</sup> For an elaboration on these issues, see Gartner|G2 & Berkman Center, *Copyright and Digital Media in a Post-Napster World*, Version 2, Updated January 2005, available at <http://cyber.law.harvard.edu/media/files/wp2005.pdf>; See Sacha Wunsch-Vincent and Graham Vickery, *Digital Broadband Content: Music*, DSTI/ICCP/IE(2004)12/FINAL available at <http://www.oecd.org/dataoecd/13/2/34995041.pdf>.

<sup>9</sup> <http://www.heise.de/english/newsticker/news/61020>.

<sup>10</sup> <http://www.apple.com/pr/library/2005/aug/08itms.html>.

<sup>11</sup> <http://www.ifpi.com/site-content/press/20050721a.html>.

<sup>12</sup> IFPI, *Digital Music Report 2005*, p. 5, available at <http://www.ifpi.com/site-content/library/digital-music-report-2005.pdf>.

<sup>13</sup> For further discussion, see Berkman Center, *Content and Control: Assessing the Impact of Policy Choices on Potential Online Business Models in the Music and Film Industries*, January 2005, p. 12, available at [http://cyber.law.harvard.edu/media/files/content\\_control.pdf](http://cyber.law.harvard.edu/media/files/content_control.pdf).

<sup>14</sup> According to this study by market research firm NPD Group Inc., iTunes has surged to a tie for second place as the most popular online source with 1.7 million U.S. households downloading at least one song in March 2005. That put

Despite the fast and impressive growth of legitimate online music services, the number of legal downloads remains small when compared to the massive number of songs downloaded from unauthorized P2P file-sharing platforms.<sup>16</sup> Even after an intensive and internationally orchestrated legal campaign against file-sharers on the one hand and the U.S. Supreme Court's *Grokster* decision on the other, file-sharing activities on P2P networks have not dropped, although the growth rates reportedly declined compared to previous years.<sup>17</sup> Interestingly, though, the P2P population has experienced a substantial increase over the summer months: the number of users jumped from 8,888,436 simultaneous users in June 2005 to 9,496,203 in July 2005. It took the P2P population almost 6 months (from January to June 2005) to experience that amount of growth, and the summer months are supposed to be the weakest times for file sharing.<sup>18</sup>

Gartner|G2 analyst Mike McGuire and the Berkman Center's Digital Media team in their reports have repeatedly emphasized the strategic importance of the depth or richness of online stores' music catalog—especially vis-à-vis P2P networks' ability to provide an enormous variety of genres, labels, artists, etc.<sup>19</sup> Since our first report, iTunes' repertoire has expanded significantly: Today, the store offers the largest legal download music catalog with over 1.5 million songs in the U.S.<sup>20</sup> and with an average of roughly one million songs in other countries. Especially in the European context, however, iTunes had and has to overcome obstacles to get a deep catalog. First, complex clearing processes involving many national rights organizations had been an impediment.<sup>21</sup> Second, independent music labels initially refused to license music to Apple's online music store based on economic considerations.<sup>22</sup> In the meantime, however, iTunes reached licensing agreements with the important independent labels, including (among others) Beggars Group, Sanctuary Records Group, and V2.<sup>23</sup> In Japan, Apple had to go through hard negotiations with the major recording companies. Reportedly, the labels were concerned about the apparent weakness of the Company's DRM

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it neck-and-neck with P2P service LimeWire and slightly behind WinMX, another P2P service. Napster came in at No. 7 and Real's Rhapsody at No. 9 behind Kazaa and BearShare. See [http://www.npd.com/dynamic/releases/press\\_050607.html](http://www.npd.com/dynamic/releases/press_050607.html).

<sup>15</sup> Among the limitations of the study: It excludes, for example, eDonkey, eMule, and BitTorrent. Further, legitimate services like Napster's and Rhapsody's "all-you-can-eat" subscription services were not included in these rankings. Moreover, multiple downloads in any service or network reportedly count as a single "use" of that service or network in the study's measurement scheme. The study, finally, does not address the question whether new iTunes users are becoming long-term customers, or how the total number of transactions on iTunes compares to the swaps made on the P2P networks. See, e.g., critique at <http://blogs.law.harvard.edu/cmusings/2005/06/07>. See also <http://digitalmusic.weblogsinc.com/entry/1234000703045984/> and <http://digitalmusic.weblogsinc.com/entry/1234000180046153/>.

<sup>16</sup> See Sacha Wunsch-Vincent and Graham Vickery, *supra* note 8, p. 12.

<sup>17</sup> According to an IFPI statement, there was a 3 percent increase in illegal file-sharing to 900 million in July 2005, from 870 million at the start of the year. See <http://www.siliconvalley.com/mls/siliconvalley/news/editorial/12187540.htm>.

<sup>18</sup> <http://www.slyck.com/news.php?story=880>.

<sup>19</sup> See, e.g., Berkman Center, *Content and Control: Assessing the Impact of Policy Choices on Potential Online Business Models in the Music and Film Industries*, January 2005, available at [http://cyber.law.harvard.edu/media/files/content\\_control.pdf](http://cyber.law.harvard.edu/media/files/content_control.pdf).

<sup>20</sup> <http://www.apple.com/itunes/store/>.

<sup>21</sup> See EICTA, *Position Paper on Digital Content Distribution and Digital Rights Management*, November 2003, p. 13, available at <http://www.eicta.org/files/EICTA%20position-DRM-120454A.pdf>.

<sup>22</sup> <http://www.guardian.co.uk/business/story/0,3604,1239201,00.html>.

<sup>23</sup> See Berkman Center, *supra* note 3, p. 3. See also <http://www.apple.com/pr/library/2004/jul/21indie.html>.

technology and they feared a huge decline in CD sales.<sup>24</sup> Japanese artists on those labels decided to release their repertoire in the iTunes directly.<sup>25</sup> Licensing renegotiations with labels outside Japan are said to be scheduled for next year, with pricing expected to be a big area of discussion. Specifically, labels have been pushing Apple to increase its current fixed à-la-carte prices in the US, Canada and Europe.<sup>26</sup> The reach of the current catalogs of online music stores such as iTunes, however, should not be overstated. ASCAP, for instance, represents a repertoire of over 8 million copyrighted musical works of every style and genre.<sup>27</sup>

Probably the most important development surrounding the iTunes Music Store's has taken place at the intersection of the code and content layer when Apple—following an important trend in the digitally networked environment<sup>28</sup>—added a podcast-subscription feature and a directory of podcasts to its June 2005 release of the iTunes software. iTunes 4.9 now offers built-in support for podcasting so that users can find, listen, subscribe to and manage podcasts.<sup>29</sup> Enhanced podcasts can make use of the iTunes song artwork viewer in order to display chapters containing reference pictures or web links and the like. However, it's important to note that iTunes itself does not support the creation of podcasts—a fact that has been criticized by some observers.<sup>30</sup> The short-term effects of the new feature are straightforward. As with music, Apple makes it easy for a user to pick a podcast that meets her tastes and interests, to download and integrate it into her existing library, and easily transfer it to an iPod. Viewed from Apple's perspective, the new feature enables the offering of additional content that, in turn, might further stimulate users' interest in the iTunes and, ultimately, in iPods.<sup>31</sup> Indeed, in only two days after launch, iTunes customers had subscribed to more than one million podcasts from the new iTunes Podcast Directory according to a press release.<sup>32</sup> The long-term implications of a centralized directory of RSS feeds provided by a commercial player, in contrast, are somewhat less clear. Some initial reactions to the introduction of the new podcasting feature expressed concern that podcasts may become far more homogenous in order to fit Apple's standards. According to iTunes' Podcasts FAQ, submitted podcasts indeed might be subject to review before being posted.<sup>33</sup> Further,

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<sup>24</sup> <http://www.guardian.co.uk/business/story/0,3604,1239201,00.html>.

<sup>25</sup> <http://www.gadsdentimes.com/apps/pbcs.dll/article?AID=/20050810/APF/508100599&cachetime=5>. This would not be possible in the US, but in Japan most labels and artists sign a contract controlling only physical product, leaving a digital loophole (Walter Hough, "iTunes Label Negotiations Stall in Japan, Artists Jump to Apple" available at [http://www.digitalmusicnews.com/results?title=apple&query\\_start=1](http://www.digitalmusicnews.com/results?title=apple&query_start=1)).

<sup>26</sup> Walter Hough, "Big Content Gaps Characterize iTunes in Japan" available at [http://www.digitalmusicnews.com/results?title=apple&query\\_start=1](http://www.digitalmusicnews.com/results?title=apple&query_start=1).

<sup>27</sup> [http://www.ascap.com/press/2005/distribution\\_021505.html](http://www.ascap.com/press/2005/distribution_021505.html).

<sup>28</sup> A recent report by the Diffusion Group suggests that 75 percent of portable mp3 users will be accessing podcasts within 5 years, a massive increase from just 15 percent today. The report projects that 60 million users will be podcasting by 2010, up from 4.5 million today, see <http://www.tdgresearch.com/press044.htm>.

<sup>29</sup> <http://www.apple.com/podcasting/>.

<sup>30</sup> [http://daringfireball.net/2005/07/podcast\\_pocket](http://daringfireball.net/2005/07/podcast_pocket).

<sup>31</sup> [http://www.technologypundits.com/index.php?article\\_id=141](http://www.technologypundits.com/index.php?article_id=141).

<sup>32</sup> <http://www.apple.com/pr/library/2005/jun/30podcast.html>.

<sup>33</sup> Art. 3 of Apple's iTunes Music Store Terms of Service, however, excludes the store's liability for objectionable content. It states that users "may encounter content that may be deemed offensive, indecent, or objectionable, which content may or may not be identified as having explicit language. Nevertheless, you agree to use the Service at your sole risk and that Apple shall have no liability to you for content that may be found to be offensive, indecent, or objectionable. Content types (including genres, sub-genres and Podcast categories and sub-categories and the like)

the extent to which iTunes' readily accessible complaint system will be used—by consumers, but also by third parties such as copyright holders or lobbyists, for instance—and whether or not the complaint mechanism will have chilling effects on free speech both remain to be seen.<sup>34</sup>

### III. Legal and Regulatory Issues

In the iTunes case study, we analyzed the ways in which Apple's online music store is based on a series of complex interactions between copyright law, contract law, digital rights management schemes, and business modeling processes. More specifically, we identified four key interactions that enable iTunes' business model. Let us briefly recapitulate the main elements.

- **Contract-Copyright Intersection:** iTunes like other music stores use two legal strategies to govern the actions consumers may take with purchased digital content: limitations through contract and/or copyright law. As demonstrated, iTunes relies on license agreements with its consumers to support its business model by limiting what they can do with the content. In other words, it uses contracts to re-allocate copyright entitlements.
- **Digital Rights Management and Anti-Circumvention Laws:** Like contracts, DRM can upset the balance struck between copyright holders and the public, including fair use and first sale. Unlike contracts, DRM restrictions are self-enforcing. In our case study, we illustrated how iTunes takes advantage of its DRM system, FairPlay, and legal provisions such as those set forth in the Digital Millennium Copyright Act (DMCA) to prevent music piracy on the one hand and to limit interoperability (thus controlling secondary markets) on the other.<sup>35</sup>
- **First Sale and Business Model-Intersection:** The first sale doctrine is aimed at balancing between the copyright holder's rights and public access to copyrighted works. Therefore, the doctrine has an important impact both on consumers and on the public at large. The first sale exemption or the principle of exhaustion in its current interpretation, however, is rather unlikely to apply to digital works distributed over the Internet. The emergence of a digital first sale doctrine, by contrast, would likely lead to secondary markets in downloaded content such as music and movies. These secondary markets, in turn, could likely have a significant impact on online business models such as the iTunes as well as on users' opportunities to gain access to copyrighted digital content.

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and descriptions are provided for convenience, and you acknowledge and agree that Apple does not guarantee their accuracy.”

<sup>34</sup><http://playlistmag.com/forums/ubbthreads/showflat.php?Cat=&Number=3182&page=0&view=expanded&sb=5&ofpart>.

<sup>35</sup> It is noteworthy that Apple has changed its DRM restrictions unilaterally and retroactively: Since iTunes version 4.5, users can authorize up to five computers to play purchased music—up from three. On the other hand, Apple restricted the number of times users can burn a playlist containing purchased music (seven times down from ten). <http://www.corante.com/copyfight/archives/003426.html>. In our case study, *supra* note 8, p. 11 we argued that it is “highly unlikely” that the relevant provision in iTunes' ToS that reserves Apple the right to modify the usage restrictions at any time will affect songs. Apple has proven us wrong.

- Fair Use and Business Model-Interaction: Fair use is a privilege to use an individual’s copyrighted material in a reasonable manner without his consent. The specific implementations of fair use rights or privileges can vary significantly from country to country. Fair uses traditionally include copies for private study, parody, criticism, news reporting, limited personal uses, and reverse engineering for interoperability. In our case study, we explored the reverse engineering and interoperability aspect of fair use. Further, we demonstrated that iTunes, like other services, has to balance between broad consumer expectations of fair use on the one hand and a copyright holder’s desire to control the distribution and use of copyrighted works by means of contract law and DRM schemes on the other hand.

Given the results of the high-level comparative law analysis in the Berkman/Gartner|G2 case study and the diagnosed trend towards convergence among various legal systems, it does not come as a surprise that Apple has been relying on exactly those four interactions across jurisdictions. Indeed, the European incarnations of iTunes are almost indistinguishable from the U.S. version as far as Terms of Service and DRM are concerned. A comparative analysis of iTunes Terms of Service (ToS), for instance, reveals only minor differences. The following paragraphs point to some of them, but also offer a few general observations as far as iTunes’ national ToS are concerned.

- The ToS of the U.S. iTunes allow the use of products “only for personal, noncommercial use.” In France, Germany, and the U.K., there is a qualification to this requirement. The relevant provision prohibits transferring, assigning or sublicensing products only “to the extent permitted by law.” This formulation indicates that certain provisions in European copyright and consumer protection laws might preempt contract law—a legal issue already identified in the foundational case study. Consider, for example, a German consumer who seeks to sell her iPod loaded with songs from iTunes to a friend. According to a mandatory provision set forth by the German Copyright Act, this sort of transfer (of products purchased on iTunes) is permissible, and contractual provisions to the contrary would be considered to be void. By including the above-mentioned caveat, Apple avoids the risk of the relevant clause being declared void in a potential dispute.
- The availability of iTunes is limited to the country specified in the relevant national ToS. From an economic viewpoint, this geographical segmentation allows Apple and the rightsholders, respectively, to charge different prices per song depending on where the songs are purchased. It is noteworthy that this practice of price discrimination motivated the UK Office of Fair Trading (OFT) to refer Apple’s iTunes to the European Commission following a complaint by the consumer association “Which?”, claiming that UK consumers pay 20 per cent more than French and German iTunes consumers, while EU law would require that UK consumers can enjoy the same benefits of a single market as citizens of other EU member states.<sup>36</sup> From a legal perspective, the above-mentioned clause might also be seen as means to address the Internet jurisdiction issue by targeting its consumers. Such a practice is often used to protect providers from the forced jurisdiction of consumers who may hide information like their true domicile.

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<sup>36</sup> <http://www.offt.gov.uk/news/press+releases/statements/2004/itunes.htm>. According to The Register, the European Commission confirmed it was looking into the allegations brought to its attention by OFT; *see* [http://www.theregister.co.uk/2005/02/25/ec\\_probes\\_apple/](http://www.theregister.co.uk/2005/02/25/ec_probes_apple/).

In order to be effective, however, it has been required that “those businesses (...) [are] diligent in making sure they follow their own self-regulation.”<sup>37</sup> Consequently, Apple in its ToS reserves the right to use technologies needed to verify that the user is not using the service from outside the available territory.

- Another observation concerns the applicable law in the various national incarnations of iTunes’ ToS. According to the U.S. version of iTunes ToS, the laws of the state of California govern the use of the service. The law governing the British, French, German, and Swiss contracts, in contrast, is English law. However, it remains an open question whether all national courts would, in fact, enforce Apple’s choice-of-law clause to the extent that consumer contracts are concerned. With regard to consumer contracts, international civil procedure laws in many European countries as well as important conventions such as the Rome Convention generally require that the choice of law made by the parties does not have the result of depriving the consumer of the protection granted by the laws of the country in which she has her habitual residence.

As in the U.S., Apple has used both its DRM system FairPlay and corresponding anti-circumvention laws in order to limit interoperability and, thus, controlling secondary markets. In the EU, Apple’s FairPlay is backed-up by the EU Copyright Directive and national laws transposing the directive, which sets forth legal provisions aimed at protecting technological measures.<sup>38</sup> However, Apple has also launched its store in countries such as Switzerland where anti-circumvention provisions haven’t yet been enacted.<sup>39</sup> Further, it remains uncertain whether national laws across Europe provide the same level of protection for Apple’s DRM system, or whether it might eventually be legal to circumvent FairPlay in some (Nordic) countries for specific purposes—such as playing purchased songs on an MP3 player other than iPod.<sup>40</sup>

Resistance to Apple’s approach not to license DRM technology to other providers has formed on both sides of the Atlantic. There have been attempts to decrypt Apple’s FairPlay. A software package named PlayFair can remove the encryption from files using FairPlay DRM technology. Reportedly, Apple’s legal department forced PlayFair to be removed from several websites on different continents. In the meantime, other pieces of code have been developed to circumvent Apple’s DRM scheme, while Apple responded with updates of its iTunes software. However, technological counter-measures have not only come from hackers, but also competitors. In August 2004, RealNetworks introduced Harmony, a piece of software that converts songs from Real’s music store Helix-DRM into the DRM-format used by the iPod, hereby enabling users to play Real’s songs on Apple’s iPod. It remains an open question whether the creation of Harmony was in compliance with the DMCA or not, i.e., whether it qualified as an anti-circumvention device, whether Real violated access control technology, or whether RealNetworks’ action—providing for the interoperability of

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<sup>37</sup> See Timothy P. Lester, *Globalized Automatic Choice of Forum: Where do Internet Consumers Sue?*, 9 New Eng. J. Int’l & Comp. L. 431, 2003, p. 10.

<sup>38</sup> See Urs Gasser and Michael Girsberger, *Transposing the Copyright Directive: Legal Protection of Technological Measures in EU Member States*, available at <http://cyber.law.harvard.edu/media/files/eucd.pdf>. For an update of the state of implementation, please visit <http://cyber.law.harvard.edu/media/eucd>.

<sup>39</sup> A revision of the Swiss Copyright Act is under way, see <http://blogs.law.harvard.edu/ugasser/2004/10/13#a18>.

<sup>40</sup> For further discussion, see Gasser & Girsberger, *supra* note 38.

music files—placed it within the “reverse engineering” safe harbor of the DMCA.<sup>41</sup> Apple responded to this move by Real with an upgrade of its iTunes software.<sup>42</sup> However, Real Networks introduced a new version of Harmony in April 2005, restoring the compatibility between the iPod and Real’s pay-per-download store. However, the iPod will not work with Real’s new subscription service<sup>43</sup>. Purportedly, Apple’s new reaction might be bringing legal suit against Real Networks.<sup>44</sup>

Apple’s decision not to license its DRM technology to other parties has also provoked legal actions brought by stakeholders representing different interests. In several cases, competition law issues have come up for discussion:

- In August 2004, Virgin Group’s French online music joint venture with media company Lagardère claimed that Apple was guilty of anti-competitive behavior under French law by refusing to license its iTunes DRM technology to its competitors.<sup>45</sup> However, the case was rejected in late 2004. The French competition authorities noted that there are plenty of WMA-compatible devices on the market for VirginMega to sell to.<sup>46</sup>
- The French consumer association “Union Fédérale des Consommateurs – Que Choisir,” for instance, launched legal action over Sony and Apple’s proprietary music formats, claiming that the respective digital rights management used by both companies, which prevents songs bought from their online music shops from being played on other manufacturers’ media players, is limiting consumers’ choice.<sup>47</sup> According to the Register, “UFC-Que Choisir” wants the two companies to open up their music stores to other device makers and to cough up €30,000 (\$38,595) in compensation.<sup>48</sup>
- Individual consumers initiated legal actions, too. In January 2005, an unhappy iTunes customer reportedly sued Apple, alleging the company breaks antitrust laws by allowing iTunes to work only with its own music player, thereby freezing out competitors.<sup>49</sup> The suit charges that “Apple has unlawfully bundled, tied, and/or leveraged its monopoly in the market for the sale of legal online digital music recordings to thwart competition in the separate market for portable hard drive digital music players, and vice-versa”.<sup>50</sup>

The question as to whether Apple could be forced to meet requests from other online retailers to grant licenses to the FairPlay technology has especially been debated in the context of EU competition law.<sup>51</sup> In

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<sup>41</sup> Gartner|G2 & Berkman Center, *supra* note 8, p. 27.

<sup>42</sup> <http://en.wikipedia.org/wiki/FairPlay>.

<sup>43</sup> [http://www.betanews.com/article/Real\\_Puts\\_iPod\\_Back\\_in\\_Harmony/1114563293](http://www.betanews.com/article/Real_Puts_iPod_Back_in_Harmony/1114563293).

<sup>44</sup> <http://www.pcpro.co.uk/news/76008/real-under-shadow-of-apple-harmony-attack.html>.

<sup>45</sup> [http://www.theregister.co.uk/2004/08/06/apple\\_vs\\_virgin/](http://www.theregister.co.uk/2004/08/06/apple_vs_virgin/).

<sup>46</sup> [http://www.theregister.co.uk/2004/11/11/apple\\_vs\\_virgin\\_ruling/](http://www.theregister.co.uk/2004/11/11/apple_vs_virgin_ruling/).

<sup>47</sup> [http://news.com.com/Apple%2C+Sony+sued+over+DRM+in+France/2100-1027\\_3-5575417.html?part=rss&tag=5572876&subj=news.1027.5](http://news.com.com/Apple%2C+Sony+sued+over+DRM+in+France/2100-1027_3-5575417.html?part=rss&tag=5572876&subj=news.1027.5).

<sup>48</sup> See [http://www.theregister.co.uk/2005/02/14/apple\\_sony\\_sued/](http://www.theregister.co.uk/2005/02/14/apple_sony_sued/).

<sup>49</sup> [http://news.com.com/Lawsuit+claims+Apple+violates+law+with+iTunes/2100-1027\\_3-5514244.html?tag=cd.top](http://news.com.com/Lawsuit+claims+Apple+violates+law+with+iTunes/2100-1027_3-5514244.html?tag=cd.top).

<sup>50</sup> [http://www.theregister.co.uk/2005/01/07/apple\\_itunes\\_antitrust\\_suit/](http://www.theregister.co.uk/2005/01/07/apple_itunes_antitrust_suit/).

<sup>51</sup> Reckon, *The iTunes Music Store: Does competition law hold the key to a closed shop?*, September 2004, available at <http://www.reckon.co.uk/ReckoniTunesSep2004.pdf>.



fact, the European Court of Justice decided in *IMS v. NDC*<sup>52</sup> that dominant firms, under “exceptional circumstances” might have an obligation to provide a third party with access to copyrighted materials. Under this standard, a dominant firm that refuses to license a copyright to give access to a product or service which is indispensable for carrying on a particular business would be considered to act abusively if (1) the refusal precludes all competition in a related secondary market, (2) the refusal prevents the emergence of a new product for which there is consumer demand, and (3) if the refusal is not objectively justified. As discussed elsewhere, it seems rather doubtful whether these conditions are met in the case of Apple’s FairPlay, especially because it must be demonstrated that a failure to license precludes (and not merely impedes or lessens) competition.<sup>53</sup> It also remains an open question as to what, exactly, the relevant secondary market is for which the relevant license might be an essential precondition. As a legal memorandum puts it, the “market definition for retail markets would lie at the heart of any case against Apple’s refusal to license FairPlay to other retailers of music downloads.”<sup>54</sup>

#### IV. Policy Considerations

Beyond the legal and regulatory issues discussed in the previous section, the expansion of Apple’s iTunes Music Store has given reason to broader policy debates about consumer rights in the digital age in general and fair use/fair dealing in particular, about global and interoperable technical infrastructures on DRM systems, and about music licensing in the digitally networked environment.

In the Berkman/Gartner|G2 iTunes case study, we critically discussed how business models such as the one underlying Apple’s iTMS are likely to further destabilize the balance between rightsholders’ interests on the one hand and users and societal interests on the other hand. Specifically, we demonstrated in our reports how DRM systems in tandem with anti-circumvention legislation and in combination with restrictive ToS’s may have a negative impact on users’ rights such as fair use or first sale.<sup>55</sup> In the meantime, a broader policy debate surrounding these issues has emerged, taking place in several arenas and on different levels. Most prominently, the Organization for Economic Co-operation and Development (OECD) emphasized that “... developers of DRM, players in the market employing DRM, and users of DRM-protected material should be equally concerned to ensure appropriate usage rights, transparency, privacy, as well as ease and reliability of access.”<sup>56</sup> In the United States, similar considerations have led to several bills that have gained at least some momentum vis-à-vis revitalized consumer rights discussion triggered by new business models like iTMS. The Digital Media Consumers’ Right Act (DMCRA) introduced in 2003, for instance, seeks to restore fair use rights under the DMCA by declaring that circumvention of a technological measure must result in copyright infringement for the circumvention to create liability. The measure also protects the distribution and use of tools that circumvent technological restrictions if those tools enable significant non-infringing use of a

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<sup>52</sup> *IMS v. NDC* C-418/01 [2004] available at <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:62001J0418:EN:HTML>.

<sup>53</sup> *Supra* note 44.

<sup>54</sup> *Id.*

<sup>55</sup> See also Gasser & Girsberger, *supra* note 38.

<sup>56</sup> Sacha Wunsch-Vincent and Graham Vickery, *supra* note 8, p. 94.

copyrighted work. Finally, the DMCRA explicitly protects circumvention when necessary for scientific research and mandates labels on copy-protected CDs. Some critics believe the last provision will unnecessarily increase CD production costs, thus hurting consumers. Consumer rights advocates widely support the bill, lauding it as a reaffirmation of the fair use doctrine.<sup>57</sup>

In Canada, many argue for the adoption of a fair use provision as described above; dropping the private copying system currently in force. This system establishes a levy on recording media such as blank CDs in return for the right to make personal, non-commercial copies of music. However, last month, the Supreme Court of Canada affirmed the legality of the levy but rejected an attempt to apply it to digital audio recorders such as the iPod<sup>58</sup>. The Supreme Court affirmed that permanently embedded or non-removable memory incorporated into digital audio recorders does not qualify as “recording medium”. As there is no exemption under the Canadian Copyright Act to permit copying personal CD’s onto an iPod, this decision may render that practice illegal.<sup>59</sup>

The debate about DRM standards and interoperability has emerged on both sides of the Atlantic.<sup>60</sup> Especially the European Commission, however, gained much attention by addressing DRM issues in general and the interoperability of DRM systems and services in particular. In a 2004 document, the Commission argues that the choice of the appropriate business model for the rightsholders and commercial users remains to be determined, and suggests that the use of DRM systems and services remain voluntary and market-driven.<sup>61</sup> However, the Commission also makes clear that “the establishment of a global and interoperable technical infrastructure on DRM systems based on consensus among the stakeholders appears to be a necessary corollary to the existing legal framework and a prerequisite for the effective distribution and access to protected content in the internal market.” The European Commission concludes that close monitoring of market developments is essential to safeguard the public interest; however, no immediate legislative action is proposed. Similarly, a High-Level Group on Digital Rights Management, established by the Commission in the context of implementing the eEurope 2005 action plan, explored the interoperability problem and identified different factors and scenarios for the evolution of DRM standards.<sup>62</sup> DRM hearings in October 2004 organized by the Commission suggested ongoing tussles between the content and hardware industries,

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<sup>57</sup> *Supra* note 8, p. 40.

<sup>58</sup> The Supreme Court affirmed the decision of the Federal Court of Appeals, *Canadian Private Copying Collective v. Canadian Storage Media Alliance* (2004 FCA 424). The Supreme Court has further ordered collecting societies such as the Canadian Private Copying Collective (CPCC) to return the tariffs previously collected to the product manufacturer (<http://www.apple.com/ca/ipodlevies/> and <http://www.cbc.ca/story/arts/national/2005/08/08/Arts/levy050808.html>)

<sup>59</sup> See Michael Geist, “Copying Levy Hasn’t Worked Well For Anyone”, *Toronto Star*, August 8, 2005, available at <http://geistprivatecopyingfuture.notlong.com> and <http://www.michaelgeist.ca/index.php?option=content&task=view&id=924>.

<sup>60</sup> One important strand of the discussion deals with the question whether DRM-interoperability, from a conceptual perspective, can be achieved at all. See, e.g., Edward W. Felten, “A Perfectly Compatible Form of Incompatibility,” April 15, 2004, available at <http://www.freedom-to-tinker.com/index.php?p=578>.

<sup>61</sup> Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, *The Management of Copyright and Related Rights in the Internal Market*, 16.04.2004, COM(2004) 261 final.

<sup>62</sup> See [http://europa.eu.int/information\\_society/europe/2005/all\\_about/digital\\_rights\\_man/index\\_en.htm](http://europa.eu.int/information_society/europe/2005/all_about/digital_rights_man/index_en.htm).

between these industries and collecting societies, and between industry representatives and consumer advocates.<sup>63</sup>

Apparently troubled both by the delayed launch of iTunes and other music stores in Europe and lower growth rates of online music in the EU as compared to the U.S., the European Commission conducted an in-depth study on how copyright for musical works is licensed for use on the Internet. The study—focusing on so-called “inbound contracts”—concludes that the main obstacle to the growth of legitimate online services in the EU is “the difficulty securing attractive content for online exploitation. In particular, the present structures for cross-border collective management of music copyright—which were developed for the analogue environment—prevent music from fulfilling its unique potential as a driver for online content services.”<sup>64</sup> The study argues that absence of pan-European copyright licenses for online music makes it difficult for online music services to take off in Europe. Against the backdrop of these findings, the Commission has evaluated a series of options to remove these obstacles and now proposes the creation of a central and Europe-wide copyrights clearance system. In essence, a collecting society’s online repertoire and territorial licensing power would no longer be derived from reciprocal agreements but from rightsholders contracting directly with a collection society of their choice, irrespective of residence or nationality. The Commission’s proposal has provoked strong reactions, including critical responses by collecting societies such as the German performing rights society GEMA.<sup>65</sup>

A debate about a reform of the licensing system in the digital age is also taking place in the United States. While the EU is debating cross-border collective management issues of music copyright, the U.S. discussion focuses on problems related to the different sets of rights that online music service providers have to secure in order to offer their services. In the U.S., the domestic music licensing structure for non-dramatic musical works is a two-track system: One distinguishes between licensing of public performance rights on the one hand and licensing of reproduction and distribution rights on the other. When it comes to digital transmissions, however, it often becomes difficult to determine which rights are involved and, consequently, to whom a licensee must pay in order to secure the necessary rights. Under the existing licensing scheme, online music services have been engaged in numerous complex rights clearing negotiations, resulting in time delays and increased transaction costs. Arguably, the current system places legitimate service providers in a disadvantageous position to compete with P2P services. One proposal by Marybeth Peters, Register of Copyrights, addresses this problem by proposing the creation of music rights organizations (MRO). These organizations would be authorized by a copyright owner to license both the public performance of non-

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<sup>63</sup> <http://www.edri.org/edrigram/number2.20/DRM>, <http://www.edri.org/issues/copyright/drm/contact041011>, and <http://docshare.beuc.org/4/DKHJIELCHKEAELGGHPLAMMFGPDBK9DWYPK9DW3571KM/BEUC/docs/DLS/2004-01224-01-E.pdf>.

<sup>64</sup>

<http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/872&type=HTML&aged=0&language=EN&guiLanguage=en>.

<sup>65</sup> <http://www.heise.de/english/newsticker/news/62174>.

dramatic musical works and the relevant reproduction and distribution rights. Such a “uni-license” approach would purportedly address the problems described above.<sup>66</sup>

## V. Conclusion

The previous sections have made clear that the success story of Apple’s iTunes has continued—it has kept its leading role in the growing online music market. As demonstrated, this success is based on a series of important interactions between copyright and contract law, DRM, and carefully designed business practices. By and large, Apple and other providers of online music were able, without major adjustments, to export (or “copy-and-paste”) the U.S.-based models to European and other countries—thanks to an increasingly harmonized playing field in the relevant areas of law. However, the devil is in the detail as the preceding paragraphs suggest. Certain legal questions, for instance, remain open with regard to the contractual agreements between iTunes and its customers as well as with regard to the exact scope of legal protection of Apple’s DRM system, FairPlay, in European jurisdictions. More importantly, however, the “going global” of iTunes has triggered a broader debate about important policy implications and policy issues, respectively, in the digital environment. Three strands have been mentioned in this report: users’ rights, DRM interoperability, and Internet licensing. For the reasons outlined in the initial Berkman/Gartner|G2 case study, it does not come as a surprise that European policy makers have shown particular interest in these issues and are actively engaged in the debate. Against this backdrop, it seems reasonable to expect that the European Commission’s activities in the relevant areas will intensify in the years to come—especially in the online copyright law context.

In our reports, we have analyzed iTunes’ business model and its evolution as a representative of what we call the “Digital Media Store” (DMS) model. This model attempts to translate the basic structure for selling physical copies in a brick-and-mortar store into cyberspace: rightsholders sell or license to vendors who store music on their servers, and consumers then visit the store to download or stream digital content.<sup>67</sup> While iTunes has been among the most innovative and successful online stores, it remains to be seen whether the Digital Music Store model as such is the appropriate response to the relatively persistent digital media crisis viewed from the perspective of different stakeholders, including artists and users. For example, recent studies on emerging consumer trends suggests that online music is not merely about replacing offline through online shopping experiences, but about sharing and playing, i.e. about getting interactive and creative with digital content.<sup>68</sup> Services aimed at including sharing features might be the beginning of a shift in paradigm. However, it remains to be seen how well-equipped current business models are to respond to deeper shifts in the digitally networked environment—beyond file-sharing.

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<sup>66</sup> For further discussion, see Statement of Marybeth Peters, The Register of Copyrights before the Subcommittee on Courts, the Internet, and Intellectual Property, Committee on the Judiciary, United States House of Representatives 109th Congress, 1st Session, June 21, 2005, available at <http://www.copyright.gov/docs/regstat062105.html>.

<sup>67</sup> See Berkman Center, *supra* note 19, AII-1 available at [http://cyber.law.harvard.edu/media/files/content\\_control.pdf](http://cyber.law.harvard.edu/media/files/content_control.pdf).

<sup>68</sup> See, e.g., Nicole Dufft et al., *Digital Music Usage and DRM, Results from an European Consumer Survey*, May 2005, p. 25 *et seq.*, available at <http://www.indicare.org/survey>.

