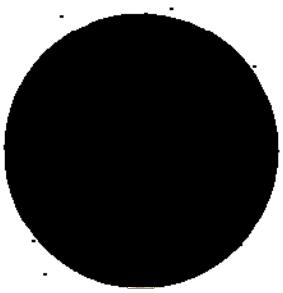

Federal Trade Commission

A Different Perspective on DRM

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at the

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The timing for this conference is impeccable. The debate over Digital Rights Management – DRM – has reignited in the last six weeks thanks to Steve Jobs, the settlement of the Sony "root kit" case, and the release of Microsoft Vista. I think this public debate is a good thing.

The focus of the debate over DRM – and rightfully so – has been on the scope of copyright. I think I bring a slightly different perspective to DRM as someone who is focused on consumer protection and competition issues. As I look at the digital marketplace, I am not sure

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software was loaded automatically onto a user's computer when the user played or burned a copy of an encrypted CD on that computer. However, the software included cloaking technology – frequently referred to as a "root kit" – that made it hard to remove from the system. At the same time, that technology left the user's computer vulnerable to external attack – in essence, it opened a backdoor for hackers. Finally, consumers had to use Sony's media player to play the music. That player would "phone home" to Sony's servers when a CD was played and it allowed Sony to monitor usage and serve ads.

The settlement focused on Sony's failure to adequately disclose the existence and effects of its DRM software and the unfair nature of Sony's installation practices. I think the case provides an excellent road map for the many consumer protection issues raised by DRM.

First, there is the failure to disclose the material limitations on consumers' use of the CD imposed by Sony's DRM technology. The Commission has long insisted that consumers be given adequate notice of the terms on which goods or services are being made available to them, including any material limitations.[3] Unless otherwise advised, I think consumers have the right to expect that their CDs come without copying limitations, and to expect that the music on those CDs will play on any device. This position is not without precedent. Several years ago, when personal digital assistants were being touted as wireless communications devices, the Commission brought actions against the manufacturers of several handheld computers. We alleged the companies failed adequately to disclose that the devices could not actually access the

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[3] *See Thompson Medical Co.*, 104 F.T.C. 648, 842-43 (1984), *aff'd*, 791 F.2d 189 (D.C. Cir.1986) (requiring simultaneous audio and visual disclosure of certain information); *see also* "Facts for Business: Dot Com Disclosures," available at http://www.ftc.gov/bcp/conline/pubs/buspubs/dotcom/index.html ("If qualifying information is necessary to prevent an advertisement from being misleading, advertisers must present the information clearly and conspicuously.").

internet wirelessly, unless the consumer also purchased additional equipment and services.[4] Likewise, with DRM, any material limitations of use rights (including, but not limited to, technological limitations such as an inability to use the media on another platform) must be clearly and conspicuously disclosed before a sale of those media is made.

Similarly, Sony did not inform consumers that its mandatory, proprietary media player would collect information from users' computers and use it to serve advertisements. I think consumers have the right to expect to be able to play their CDs on their computers, without being monitored and targeted with marketing. The Commission has challenged this type of conduct by adware purveyors,[5] and the same principles apply here. While this issue is not specific to DRM, it illustrates the potential risks for companies that may be tempted to piggyback marketing or other functions onto their DRM schemes. If piggybacking is material to consumers, and particularly if it is not expected in the context of the device or media, it must be disclosed. As a footnote, online behavioral targeting itself raises the specter of data collection and privacy violations. This is a hot topic that the Commission is closely following.

The third aspect of the *Sony* case that harkens back to established Commission cases is the undisclosed and irreversible downloading of software onto consumers' computers. We are entering a world where DRM may be implemented by way of software, hardware, or both.

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[4] *In re Microsoft Corp.*, Docket No. C-4010 (issued May 17, 2001) (consent order) (available at http://www.ftc.gov/os/caselist/c4010.htm); *In re Hewlett-Packard Co.*, Docket No. C-4009 (issued May 17, 2001) (consent order) (available at http://www.ftc.gov/os/caselist/c4009.htm); *In re Palm, Inc.*, Docket No. C-4044 (issued Apr. 17, 2002) (consent order) (available at http://www.ftc.gov/os/caselist/0023332/index.htm).

[5] *In re Zango, Inc. et al.*, File No. 052 3130 (issued Nov. 2, 2006) (consent order) (*available at* http://www.ftc.gov/os/caselist/0523130/index.htm); *In re Direct Revenue, LLC et al.*, File No. 052 3131 (issued Feb. 20, 2007) (consent order) (*available at* http://www.ftc.gov/os/caselist/0523131/index.htm).

Regardless of how it is delivered, consumers must know what they are getting before they buy.

The Commission has brought actions against numerous distributors of spyware and adware; a common theme in these cases is that the companies surreptitiously loaded their software and made it difficult or impossible to uninstall.[6] Sony's use of a root kit to hide its DRM software was a particularly egregious twist on that practice, made even more troublesome by the security vulnerabilities the software created. In all of these cases, the Commission has made clear that this conduct is unfair and illegal. Companies that employ DRM walk a fine line; obviously they need to ensure the viability of their mechanism in order to effectively protect their copyright. However, imposing it on consumers unilaterally without appropriate notice and consent, especially where it may have unintended effects, is problematic.

The story – at least from a consumer protection standpoint – is slightly different when one looks at the application of DRM technology in what I will call the "enterprise" sector. Here, I'm referring specifically to the use of DRM to authenticate users' rights to documents or

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[6] *FTC v. Seismic Entertainment Prods. Inc*, Civ. No. 1:04-CV-00377-JD (D.N.H. Oct. 6, 2004) (complaint) (available at http://www.ftc.gov/os/caselist/0423142/0423142.htm); *FTC v. Odysseus Marketing, Inc.*, Civ. No. 1:05-cv-00330-SM (D.N.H. Sept. 21, 2005) (complaint) (available at http://www.ftc.gov/os/caselist/0423205/0423205.htm); *see also Zango, Inc.*, and *Direct Revenue, LLC, supra* n.5.

readily found when consumers and customers entrust their confidential personal information to others – failing to make good on these representations amounts to deception under the FTC Act.[7] However, when it comes to protecting confidential personal information, the Commission's jurisprudence does not stop at disclosure requirements. Section 5 of the FTC Act prohibits "unfair," as well as "deceptive" acts and practices. The Commission has held that systemic or systematic shortfalls by custodians in protecting confidential personal information in their possession can be considered an unfair practice.

For example, the Commission obtained a $15 million settlement from the data broker Choice Point based in part on its unfair practices in failing to secure consumers' personal information, and has brought numerous similar cases.[8] It seems to me that this principle should apply to DRM when, because of a lack of reasonable procedures, a company fails to protect consumers or customers from theft or other misuse of their confidential personal information. In short, as to this use of DRM, I also think longstanding Commission principles and requirements governing liability are applicable.

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[7] *FTC v. Toysmart.com, LLC*, Civ. No. 00-11341-RGS (D. Mass. filed Jul. 10, 2000) (complaint) (available at http://www.ftc.gov/opa/2000/07/toysmart.htm); *In re Eli Lilly and Co.*, Docket No. C-4047 (issued May 8, 2002) (consent order) (available at http://www.ftc.gov/os/caselist/0123214/0123214.htm); *In re Gateway Learning Corp.*, Docket No. C-4120 (issued Sept. 17, 2004) (consent order) (available at http://www.ftc.gov/os/caselist/0423047/0423047.htm).

[8] *See United States v. ChoicePoint, Inc.*, Civ. No. 106-CV-0198 (N.D. Ga. Feb. 15, 2006) (settlement) (available at http://www.ftc.gov/os/caselist/choicepoint/choicepoint.htm); *see also In re CardSystems Solutions, Inc.*, Docket No. C-4168 (Sept. 5, 2006) (consent decree) (available at http://www.ftc.gov/os/caselist/0523148/0523148.htm); *In re DSW, Inc.*, Docket No. C-4157 (Mar. 7, 2006) (consent decree) (available at http://www.ftc.gov/os/caselist/0523096/0523096.htm); *In re BJ's Wholesale Club, Inc.*, Docket No. C-4148 (Sept. 20, 2005) (consent decree) (available at http://www.ftc.gov/os/caselist/0423160/0423160.htm); settlement in *Gateway Learning*, *supra* n. 7.

I believe the Commission has the tools to handle many of the emerging consumer protection issues raised by DRM under its existing statutory authority to prohibit deceptive or unfair practices. The Federal Trade Commission Act has proven very adaptable to changing times. Therefore, at this point, I do not think that we need specific DRM legislation from a consumer protection standpoint. This is not to say, however, that I think the Commission has all the remedial tools it needs to deal with breaches of privacy or other harms attributable to defective DRM. I don't think those tools are adequate. More specifically, for most unfair or deceptive acts or practices, the Commission can and does seek equitable remedies, including consumer redress or disgorgement. In the *Sony* case, for example, consumers were offered refunds and reimbursement to repair any damage to their computers. In reality, however, much of the harm in the *Sony* case and similar cases – restricted use of lawfully-purchased music, breaches of privacy, and unwanted intrusion into users' computers – is difficult to quantify monetarily. And, the companies responsible for the harms do not always have ill-gotten gains to disgorge. Consequently, either through Congressional action or through rulemaking action at the Commission, I would like to see the Commission armed with the authority to seek civil penalties in these types of cases.

II. COMPETITION

I would like to turn to some of the antitrust issues implicated by DRM.

As is so often the case with software, interoperability is front and center in terms of the antitrust issues. Apple, Microsoft, Sony, and others have developed different DRM technologies to encrypt digital content. This has given some comfort to the copyright holders concerned with piracy. However these competing DRM standards limit interoperability – Microsoft's Zune is incompatible with Apple's iTunes. Undeniably, consumers would benefit from increased

interoperability in the digital music marketplace – at least in the short term. The lack of interoperability – and Apple's market share – has led some to argue that antitrust should be brought to bear. However, I for one am not sure that antitrust – at least at this point in time – should be used to force these companies to make their products interoperable with their competitors.

Apple has sparked the most controversy largely because of the success of iTunes and iPod. Apple has sold over 90 million iPods since 2001 and over 2 billion songs on its iTunes Music Store – no one else comes close in either market. This success has led some to argue that Apple's tactics violate the antitrust laws.[9] Apple's refusal to license its DRM solution – FairPlay – to third parties and its refusal to use anything but FairPlay has meant that there is limited interoperability between Apple's products and competitors' products. This has made it difficult, if not impossible, for the average consumer – such as myself – to transfer music from iTunes to third party devices. It also means that it is difficult to play music encrypted with third party DRM on an iPod. However, iPod owners are not necessarily locked into iTunes for music –

[9] For example, a class action complaint brought here in the Northern District of California alleges that Apple's strategy of "tying" the iPod and iTunes violates federal and California antitrust laws. Authorities in Europe are also looking into whether this practice violates their laws. The Norwegian Consumer Ombudsman ruled in January 2007 that Apple's closed system is illegal because the songs sold on iTunes, encoded with Apple's FairPlay DRM, cannot be played on any music device other than an iPod.

grow and it is expected to for some time. In other words, there are still a number of consumers who have not purchased a device. Today there are a number of devices on the market – Toshiba, Microsoft, Sony, SanDisk, and iRiver to name a few. Apple may have the largest installed base today but it is unclear whether that will remain the case in the future. At the time of the government's Microsoft challenge the market was far more developed. Microsoft had an enduring decade-long monopoly in the operating system and there were few alternatives in the marketplace. I think it is too soon to say whether the lion's share of device customers will ultimately be locked into Apple's product. Second, studies suggest that the vast majority of music on iPods today is not purchased from iTunes. Rather, it comes from non-encrypted sources – largely compact discs – that can easily be ported to other devices.

Some have argued that the various stakeholders should coalesce around a marketplace standard for DRM. The Coral Consortium, Sun's DreaM project, and the Digital Media Project are three examples of ongoing standard-setting efforts in the DRM marketplace. Yet none of these efforts have made much headway on the problem. Standard setting can be enormously beneficial to consumers. At the same time, some stakeholders are wary of participating in these efforts because they can be manipulated. We have seen that some seek to manipulate the standard-setting process in ways that implicate the antitrust laws and that ultimately may result in supra-competitive prices and/or sub-competitive quality that ultimately hurt consumers. The Commission's recent *Rambus* case is a case in point.[12]

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[12] *In re Rambus Inc.*, Docket No. 9302 (issued Aug. 2, 2006) (opinion of the Commission and final order), available at http://www.ftc.gov/opa/2006/08/rambus.html. There the respondent engaged in deceptive practices respecting its patents and patent applications during a standard-setting process. The result was incorporation of the respondent's intellectual property into two SDRAM standards and the respondent's illegal acquisition of monopoly power in violation of Section 2 of the Sherman Act. The Commission imposed a ceiling on the royalties the respondent could exact in those circumstances.

[14] Edgar Bronfman Jr., speaking at an investor conference in New York, publicly aired the frustrations of music executives with the pricing structure of Apple's iTunes, the

However, an agreement by the labels on a business model – for example, the adoption of a variable pricing scheme – could also violate Section 1. If there were hard core agreements, they might be viewed as horizontal price fixing or market division agreements that are illegal per se under the Sherman Act. By the same token, if and to the extent that uniformity is just the result of rivals monitoring and imitating each other, and there are no "plus" factors, that would probably not be considered illegal under the antitrust case law.