FROM PIRACY TO PROFIT?

ONE YEAR AFTER IMPERSONAL NETWORK TO RIAA-
ENDORSED PLAYER,
P2P PANACEA IS STILL
A LONG WAY OFF
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Last October iMesh became the first peer-to-peer (P2P) network to attempt an on-the-fly conversion from piracy haven to commercial service.

The idea was simple enough: Cash in on an aggregated 5 million users by moving them over to a new on-demand subscription service that offered a two-month free trial and a competitively priced $6.95 per-month fee thereafter. To boot, there was one major concession for the entrenched file swapper. Users could still share "gray matter" content—copyrights not controlled by the major labels—for free.

The fresh start for iMesh came in the wake of the Supreme Court’s ruling on Grokster four months earlier, and it was supposed to usher in a new era of so-called "legal P2P.

In a move away from the old-school file-sharing experience, this new wave of P2P would feature a mix of reformatted file-sharing networks and new services with innovative business models for sampling music that didn’t require payment first.

But as the new iMesh approached its first anniversary, business isn’t exactly booming. And other legal P2Ps are proving slow to get off the ground.

Efforts to create new legal, "free" music networks from scratch have been complicated by the need to first develop copyright-friendly distribution and filtering technologies like SnoopCap, Napster creates Shawn Fanning’s filtering system that was discussed forever but didn’t go live until 2004.

Labels and service providers also had to hammer out a new licensing model for try-before-you-buy downloads—rights that never existed before. Mashboxx, an advertiser-sponsored downloading solution that aims to offer "free" songs to consumers who won’t pay for content, has been in development for over a year, hampered by both issues.

Meanwhile, some leading names in traditional P2P that were expected to follow in iMesh’s footsteps are either still in the throes of litigation with the music business (Morpheus, LimeWire) or have folded post-settlement due to a lack of funds (eDonkey). Still others have had their brands gobbléd up by other companies targeting the legal P2P business; BearShare was acquired by iMesh in May while Grokster was snapped up by Mashboxx last September.

But after 12 months of frustration, fresh signs of promise are emerging from the legal P2P space.

iMesh relaunched the BearShare brand under its copyright-friendly technology platform in August. A post-RIAA settlement Kazaa is working on launching a legal version of its network. And BitTorrent is making inroads with the film industry, striking a first-of-its-kind movie download deal with Warner Bros. Home Video in May.

Label licensing deals with ad-supported downloading services—upstarts Spiradab and QTrack, as well as Mashboxx—are also on the rise. All three companies vow to launch their respective services by year’s end.

“We’re excited to get some of the legal issues behind us and clarify the rules of the game,” EMI VP of business development Ken Parks of legal P2P. "Now we can focus on building legitimate business models."

Billboard breaks down the players targeting the P2P space.
P2P NETWORKS

IMESH
Ownership: Private
Management: Robert Summer, CEO. Summer is a former RIAA executive who has also served stints with RCA and Sony Music International.

Licensing deals: All the major labels and leading independents, as well as music publishers.

Portability: Yes

Launch date: Oct. 25, 2005

Business model: iMesh offers a three-tiered model—one on-demand subscription service for $7.95 per month up from an initial rate of $6.95, a portable subscription rate of $14.95 and a download store that sells songs for 99 cents and albums for $9.99. Users can also continue to trade nonmajor label content free of charge. There are no public figures available for iMesh subscriptions or sales, but Summer acknowledges that the service is still a work in progress. However, he says iMesh has proved that a legal P2P model can at least launch. He also says new improvements, including the addition of subscription portability, MySpace-esque social networking features and the launch of the BearShare brand in August, should help drive customer conversions. "We're a first-to-market player experiencing the agony of the process of waiting to offer the value of P2P to the marketplace," Summer says. "How quickly the rest of the legal P2P market will grow is subject to the same limitations that were limiting the takeoff opportunity iMesh had."

BITTorrent
Ownership: Private
Management: Ashwin Navin, co-founder/president
Licensing deals: Warner Bros. Home Entertainment Group, Koch Entertainment (video content), the Orchard (video content), Hart Sharp Video, Egami Media (a subsidiary of Image Entertainment)

Portability: No

Launch date: Late fall 2006 (estimated)

Business model: BitTorrent, the favored tool of tech-savvy video file swappers, in May became the first operator of a P2P technology to ink a deal with a major movie studio, Warner Bros. The move followed a late-November 2005 agreement between the Motion Picture Assn. of America and BitTorrent in which the latter agreed to rid its search engine of links to pirated content. But the San Francisco-based company—which ultimately wants to pull in a variety of film, TV and music partners for its new commercial service—is yet to announce any licensing deals with the major labels. Company sources say they are hoping to launch with music videos this year and introduce audio downloads in 2007. BitTorrent has been in talks with the RIAA and reps for the major labels about content licenses for months. But given recent industry division over whether YouTube should first settle with the RIAA before making content available for distribution, that may be an uphill battle.

KAZAA
Ownership: Sharman Networks
Management: Nikki Hemmings, CEO
Licensing deals: None

Portability: NA
Launch date: NA

Business model: After settling with the entertainment industry in July for more than $100 million, Kazaa is in the midst of transitioning its user base from a free P2P network to a commercial service. At the height of its popularity the file-sharing network reportedly claimed as many as 4 million users worldwide. Beginning July 27, new Kazaa users began downloading software with a filtering technology that weeds out copyrighted works from major labels and film studios. Still to be seen is what form a legitimate version of Kazaa will take, and how quickly Sharman Networks can get an offering up and running. Hemmings says the company will look to pursue multiple offerings, including a possible subscription service. The company is in negotiations with major labels and publishers about content licenses. RIAA Chairman/CEO Mitch Bainwol says, "We're hopeful that as Kazaa moves into a legitimate model that it's successful. We're now in a partnership."

IMESS: A LEGAL P2P FACES UPHILL BATTLES

Getting Out Of The Gates May Be Tough For Many New Legal Peer-To-Peer Offerings, But Actually, That's The Easy Part

iMesh has proved that convincing consumers to switch from free to pay is the real challenge. The company declined comment on its subscriber numbers, but one technology analyst at a major label says the service has "stumbled out of the gates" in converting its user base into paying customers. That may be because iMesh is still competing with free.

In recognition of the power of the iMesh brand in the P2P community, users are still flocking to the service. The company's software has been downloaded more than 100 million times in the last year according to Cnet's Download.com. Partially driving that volume is the fact that iMesh forced all its users to upgrade to a new version of its RIAA-sanctioned software. However, based on the decidedly mixed user reviews on Download.com, consumers are taking issue with the refurmed iMesh's for-pay model. Even with the availability of "gray matter" content—copyrights not controlled by the major labels—many of the comments on the service focus on the lack of free content. (iMesh is using content-filtering technology from Audible Magic to keep copyrighted works out of the free area of the site.)

The most recent data from digital research firm NPD backs up the notion that P2P users remain entrenched in their unwillingness to pay. The number of Internet households using P2P networks grew 19% in the last year, rising to 7.5 million households in August up from 6.3 million in August 2005. By contrast, the number of Internet households paying for either tethered or a la carte downloads over the same period trimmed to 4 million, up from 2.1 million in August 2005. Commercial downloading claims a better growth rate than the P2P networks, but in total numbers it's not much of a comparison. More than 415 million songs were downloaded via P2P in August versus 71 million commercial downloads, NPD reports.

Even as the RIAA is busy shuttering and/or reforming some of the most popular P2P players—iMesh, BearShare, Grokster, eDonkey—consumers are shifting to other applications. NPD reports that Limewire accounted for 64.6% of all music P2P piracy in August 2006. A pre-relaunch BearShare claimed 10% share, while a resettlement Kazaa and the still-irritating Morpheus each had 4%. All other P2P networks claimed 16% share.

Meanwhile, consumers actually willing to pay for digital music are flocking to better-financed, more heavily marketed digital retailers, primarily Apple Computer's iTunes.

Percent growth in the last year in the number of Internet households using P2P networks

Lack of compatibility with the iPod is emerging as a big headache for the legitimate P2P iMesh and every legit P2P offering in development is offering tracks protected with Microsoft's Windows Media Audio digital rights management technology, rather than as open MP3 files. Critics question whether DRM-wrapped files, which won't work with iPods and often aren't portable in any form, will be effective at furing payment-averse music fans away from P2P networks that offer unlimited flexibility and no interoperability problems.

—BG
P2P Proliferation

P2P download figures have shown marked increases in the past year.

Year to Date (Millions)
Source: NPD MusicWatch

<table>
<thead>
<tr>
<th>Internet households using P2P networks</th>
<th>Internet households paying for either tethered or a la carte downloads</th>
<th>Total number of downloads via P2P networks</th>
<th>Total number of tethered or a la carte downloads</th>
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<tr>
<td>2005</td>
<td>6.3</td>
<td>4</td>
<td>290</td>
</tr>
<tr>
<td>2006</td>
<td>7.5</td>
<td>4</td>
<td>415</td>
</tr>
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</table>

Digital Sales By Channel

- Limewire
- All other P2P networks
- BearShare (pre-relaunch)
- Kazaa (pre-relaunch)
- Morpheus

4%

19%

64%

AD-SUPPORTED SERVICES

SPIRAL FROG
Ownership: Private
Management: Robin Kant (below), CEO. Kant was formerly chief executive of Universal McCann Worldwide. SpiralFrog’s board of directors includes former Sony/ATV Music Publishing president Richard Rowe, former RIAA EVP chief Jay Berman and Mobile Entertainment Forum Americas chairman Ralph Simon.
Licensing deals: Universal Music Group, EMI, Koch
Sponsors: Levi’s, Aeropolis, Benetton
Portability: Yes
Launch date: December (estimated)
Business model: Users of the service have to watch an ad before every file they download. But they can keep the tracks for up to six months and can transfer them to portable devices, though not the iPod.

MASHBOXX
Ownership: Private
Management: Wayne Rossc (above), founder/CEO. Rossc is the former chief executive of Grokster.
Licensing deals: Universal Music Group, Sony BMG, EMI
Sponsors: None
Portability: No
Launch date: December (estimated)
Business model: In addition to being available through its own proprietary application, Mashboxx says its protected files will be available as free downloads through “most of the major file-sharing networks”—including a new legit version of Grokster.
Users can play full-length tracks up to five times free of charge before they have to buy them. Sampler tracks, which cannot be transferred to a portable device, expire after the fifth play and convert to a 30-second clip. Additional details of the service are still forthcoming. Advertising will not be embedded in the file but rather on the Mashboxx site. Mashboxx was the hot ad-supported story of a year ago. But it has experienced plenty of growing pains in the last 12 months as it has attempted to get off the ground.
In August, chief executive Michael Bebel left his post less than a year into his tenure to take the top job at Rockus, a rival digital entertainment service targeting colleges and universities. Earlier in the year, the company lost its biggest industry champion, former Sony BMG CEO Andrew Lack, when in February he took the role of nonexecutive chairman of the recorded-music joint venture. The company has also seen its business model hindered by the evolution of the major labels’ thinking on ad-supported downloads, which is only coming into its own now.

QTRAX
Ownership: Brighten Technologies
Management: Allan Klepacz, president/CEO
Sponsors: None
Portability: No
Launch date: December (estimated)
Business model: New York-based Qtrax intends to offer a free sampling tier and premium subscription service when it launches later this year. The ad-financed free tier will allow users to download licensed tracks at no charge, but the PC-tethered files can be played back only five times and require using Microsoft’s Windows Media Player. To play a track more than five times, users must upgrade to Qtrax’s subscription service. However, the company is looking to create ways to extend the time in which users can interact with the content for free—rewarding more plays based for time spent on the service or for referring music to friends. Users of Qtrax won’t have to watch ads when they download files. Instead the company plans to generate advertising through paid search, banners and contextual advertising. The service doesn’t intend to offer portability at launch. Klepacz says he ultimately wants as few restrictions on the content as possible so it mirrors much of the P2P experience. “The closer the model is to current behavior, the more chance there is for success,” he says.