

Recording giants could join Bertelsmann's embrace of Napster

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30 November 2000

After an initial period of shock at Bertelsmann's decision to break ranks with the rest of the recording industry and enter into an alliance with Napster, there are indications that the major players are ready to do business.

Napster is the controversial Internet service that allows users to swap recorded music files for free. Its creator, 18 year old university freshman Shawn Fenning, developed a "peer to peer" system in which users could download music directly from one another's computer hard disks without the files needing to be located on a central sever. The Napster technology provides the central database through which users can search for files and the software by which to download and play them.

The technology upon which Napster is based has been highly praised. Not so for its business model, however. Since its inception the company has been embroiled in legal action by the recording industry and some artists, alleging that Napster is facilitating illegal downloads of copyrighted music and undermining the intellectual property rights of the recording labels and the artists.

With a user base of around 40 million, Napster found itself at the centre of a debate focusing around the music fans right to free music. Many commentaries that have appeared over the last six months have presented Napster as the champion of free music on the Internet, against the recording giants who wish to maintain their own monopoly. In contrast, Napster's executives have insisted they are open to discussion with the recording giants and that a viable business model could be developed.

With Bertelsmann's announcement last month of a strategic alliance with Napster, the conciliatory remarks of the Napster defence team moved out of the arena of

court room propaganda towards the world of business negotiation.

Under the terms of the alliance announced October 31, Bertelsmann will make its digital music library available to Napster and drop its legal action, once the new subscription-based service is in place.

It is rumored that Bertelsmann will spend up to \$50m in the development of Napster's business model and will take a 40 percent stake in the company. The head of Bertelsmann's e-commerce division, Andreas Schmidt, has said he expects about 80 percent of Napster users would be willing to pay about \$15 a month to subscribe to the service. The company has expressed confidence that other major labels, including Sony and Universal, will join Bertelsmann's BMG in developing music sharing capabilities.

Schmidt told Reuters news agency, "I am optimistic that in the end all of them will join," saying that Bertelsmann had held talks with "all the majors, at various levels... together with Napster."

Though details of the plan remain cloudy, statements by Bertelsmann have made clear that the agreement with Napster is seen as of central importance to the company's overall strategy, not simply its music sector.

According to an article on *Wired News*, since last year Bertelsmann has been developing a digital distribution superhighway through its Digital World Services (DWS) division. The goal is said to be to create the infrastructure to deliver secure digital media to retailers throughout the world.

"Besides music, we are moving toward having our first publishing house online in Q1 of next year," said Johann Butting, CEO of the DWS division of Bertelsmann. "We're already looking into movies, then games will come later. Eventually, we'll be looking into (other) business opportunities."

For all the talk in the court room of lost revenues from CD sales and the moral obligation upon Napster to compensate artists for their work, it is now clear that the opposition of the recording giants BMG, Time Warner, Sony, Seagram and EMI to Napster was above all out of concern that they would lose control of distribution, not only for music but other media. A major factor in the actions brought by the recording industry was that Napster had trumped their own efforts to develop an online distribution model.

While others were still intent on destroying Napster, Bertelsmann took the plunge and embraced it. In doing so they have gained the upper hand in controlling the technological leap that Napster represents and gaining access to its mass user base. Schmidt estimates that, "Even if only 30 percent of the existing more than 40 million Napster users were to accept the new business model, that would be a success."

To the surprise of many, there has been no talk as yet of ending the free access to Napster that presently exists. In fact Schmidt has stated that Napster would retain its original community philosophy. "They are an independent company... it's not about dominance or taking over," he said.

In stark contrast to their insistence in the court room that the rights of intellectual property are not to be challenged, it now appears that others will soon follow Bertelsmann's willingness to give up a share of potential royalties in return for the much bigger revenue that may be generated through the implementation of the Napster model across other media.

This prompted the former producer of the 1960s rock group Jefferson Airplane to claim that Bertelsmann is helping Napster infringe copyright recordings by financing Napster's operations.

Producer Matthew Katz claims that his record label has nearly been put out of business because the file-swapping service has greatly reduced demand for CDs.

"Until something is done, they [Bertelsmann] are party to an illegal activity," Katz said. "For years, the big labels have virtually opened the door to this thing and did nothing about it. They knew this technology was in place to do this sort of thing and knew there was a way to do something to prevent this."

Exactly what Katz had in mind is anyone's guess, but the fact is that once this technology was developed and released on to the Internet, there was little left for the

recording industry other than to embrace it. Bertelsmann reluctantly recognised this in their agreement last month.



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