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Will the Apple-EMI Deal End DRM?

The music label's agreement to sell unprotected songs on iTunes has the industry abuzz about the future of digital rights management

by [Arik Hesseldahl](#) and [Peter Burrows](#)

Of all the parties walking away as winners in the deal between Apple and EMI to remove copy restrictions from digital music, Tom Cullen is among those who worked the least, but benefited greatly. Sonos, a five-year-old company that sells a line of wireless devices that play digital music tracks around the home, has always suffered because it couldn't play songs purchased from Apple's ([AAPL](#)) iTunes store.

It was a common complaint from owners of Sonos' ZonePlayer products, who had spent several hundred dollars to unlock the music stored on their computers so it could be played on stereo systems around the house over a wireless network. "I wouldn't say we lost customers because of the lack of compatibility," says Cullen, a Sonos co-founder. "But we sure spent a lot of time explaining why the songs wouldn't work on support calls. We just blamed Apple."

NO DRM FOR EMI

But now the problem is fixed—at least partially. Apple's plan to offer EMI's music via iTunes with no digital rights management (DRM) software to restrict the conditions under which songs can be copied will automatically give Sonos the compatibility it has wanted so long with at least some of the music sold on iTunes. Cullen says with luck, more labels will follow EMI's lead.

Sonos, like so many other companies that have long struggled with Apple's refusal to license its FairPlay DRM technology to any third parties—except Motorola ([MOT](#)) for the Rokr wireless phone—had approached Apple several times seeking some kind of cooperation. Apple's response was always the same: It didn't want to get into the business of supporting a bunch of hardware partners on behalf of the record labels.

This made the Apr. 2 joint announcement between Apple and EMI all the more surprising. When Apple CEO Steve Jobs formally suggested that recording labels should allow online music to be distributed without DRM protection, it seemed less likely that any would go along and more likely that DRM would remain a linchpin of digital music distribution for the foreseeable future. Still, some labels, including EMI, conducted market tests to see how unprotected songs would fare.

INTERESTING TIMING

News of their agreement came just a few hours before European Commission regulators announced that they would launch an antitrust probe against Apple and the major recording labels. The Brussels body alleges that DRM rules—which are to be changed in about a month in Europe—under which the songs are sold through iTunes violate competitive rules.

The regulators sent Apple, Universal Music ([V](#)), Warner Music ([WMG](#)), EMI, and Sony BMG ([SNE](#)) a confidential statement of objections outlining the charges last week.

News of the antitrust probe clouded what was otherwise seen as a winning play for Apple: The timing of the announcement suggests that Apple rushed to be ahead of the news of an investigation it knew was imminent.

Still, by cutting the chains of DRM, EMI and Apple are moving toward the day when a song sold from a digital store is as universally playable as a CD is today. And for some suppliers of MP3 players that don't bear the iPod name, the fact that soon they'll be compatible with at least some of the content sold in the iTunes Store will give them some added benefits to crow about.

WILL OTHER MAJORS FOLLOW?

Meanwhile, there's the issue of the other online music stores. Presumably they will in time be offered the same deal that iTunes has and will be allowed to offer DRM-free songs that are compatible with all portable players, including the iPod. One of the few who has been able to brag for some time that his music is already compatible with the iPod is David Pakman, CEO of eMusic, a New York distributor of DRM-less music produced mostly by independent labels.

He thinks the other majors will have to follow EMI's lead: "If you're a major that doesn't have DRM-free music, you look pretty challenged. This will put pressure on the other majors," he asserts. Pakman has been talking to major labels for years trying to convince them to distribute their music as unprotected MP3s to no avail. Suddenly, he says, the pace of talks on the subject has quickened. "Hopefully many other [online] retailers, including ourselves, will get licensed over time."

Rob Glaser, CEO of another Apple rival, RealNetworks ([RNWK](#)), which operates the Rhapsody online music subscription service, hopes to hear EMI knocking on his door soon. "This moves us closer than ever to the day when consumers will be able to buy their favorite music via Rhapsody and enjoy it on their iPod or any other music-playing device," he said in a statement. "We look forward to working with EMI and the rest of the music industry to bring DRM-free, interoperable music to consumers in the months ahead."

TESTING THE WATERS

However, Warner Music Group CEO Edgar Bronfman Jr., who has over the years criticized Apple's firm stance on pricing, is said to be firmly against dropping DRM anytime soon. One major-label executive who asked not to be named told BusinessWeek.com that he believes Apple's motivation has little to do with compatibility and is more about selling iPods and fighting off the complaints by European regulators.

"If Jobs really believed in interoperability, he would have licensed FairPlay from the start," says the executive. "So what does he do to shake off regulators in Europe? He goes after the weakest, most desperate music company to help him promote DRM-free."

In the meantime, Sony/BMG and Universal Music Group are understood to be testing the sale of unprotected MP3s. One music industry source familiar with the testing says that Sony and Universal are discouraged by the example set by Pakman's eMusic, which hasn't managed to turn a profit. They also worry that selling unprotected tracks might cannibalize sales to consumers using mobile phones, a fast-growing segment of digital music sales. Additionally they're concerned that selling unprotected tracks will only add to the perpetual problem of music piracy.

THE WORLD AFTER DRM

Not everyone involved is so worried. Bob Kohn, CEO of RoyaltyShare, a San Diego concern that processes payments to artists and other rights holders, says today's Apple-EMI pact will "double or triple the size of the digital download business.... I think EMI realized they could sell a lot of their back catalog by doing this and I think they're right."

Some of the companies that might be helped in a DRM-less world include would-be iTunes rivals such as Rhapsody, Napster ([NAPS](#)), and Yahoo! ([YHOO](#)), all of which could in theory be granted the rights to sell iPod-compatible music. And iTunes could easily lose much of its market share.

That's likely of little concern to Apple. The company draws only a thin profit over and above its operational costs to run the online store, while the iPod generally attracts a 50% gross margin. Having sold some 90 million iPods over five years and some 2 billion songs since 2003, the average number of iTunes songs sold per iPod stands at about 30. If the iPod and upcoming iPhone were universally compatible with all the digital music sold online, few people would argue that sales of those devices wouldn't be even greater.

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