

Written Testimony Submitted for the Record of
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on
“Promoting Investment and Protecting Commerce Online: Legitimate Sites v. Parasites, Part I”
before the
House Committee on the Judiciary
Subcommittee on Intellectual Property, Competition and the Internet
U.S. House of Representatives
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Thank you Chairman Goodlatte, Ranking Member Watt, and the Members of the Subcommittee for holding this important hearing.

Authorized online distribution of motion pictures via the internet has the potential to be the future of entertainment. But if the rule of law is not effectively applied to the internet, the internet also holds the potential to decimate the business of producing and distributing motion pictures, in the process destroying jobs across all fifty states, eliminating outlets for the expression of creativity, reducing American tax revenues, depleting American workers’ retirement and health plans, and damaging the U.S. balance of trade.

I am Frederick Huntsberry, Chief Operating Officer at Paramount Pictures Corporation, a division of Viacom Inc., and I appreciate the opportunity to appear before you to discuss this issue. As COO, I am responsible for our operating divisions, which include Finance, Human Resources, Labor Relations, Studio Operations, Information Technology, Sourcing, Business Development, Paramount’s Community and State Government Relations, Legal, and, of course, Content Protection. Every day I deal with the impact that rampant online theft of our content has on Paramount.

Paramount Pictures is a global creator and distributor of filmed entertainment, with multi-faceted divisions including digital, DVD, broadcast and cable television distribution, studio operations, and consumer products and recreation. In addition to producing films that are initially released theatrically, we also produce content directly for DVD distribution and directly for online distribution.

Paramount’s legendary history dates back to Cecil B. DeMille’s silent film *The Squaw Man*, which was the first studio film ever shot in Hollywood. In 1927, Paramount received the very first Academy Award for Best Picture, awarded to the World War I drama *Wings* – the only silent film to win that coveted

award. Paramount was, for many years, the home of Mae West, the Marx Brothers, Jerry Lewis, Bob Hope, and Alfred Hitchcock.

Over the decades Paramount has created such memorable films as *The Godfather*, *Chinatown*, *Love Story*, *Breakfast at Tiffany's*, *White Christmas*, *Grease*, *Saturday Night Fever*, the *Indiana Jones* series, *Star Trek*, *Ferris Bueller's Day Off*, *Top Gun*, *Airplane!*, *Forrest Gump*, *Braveheart*, *Saving Private Ryan*, *The Truman Show*, *Titanic* (with 20th Century Fox), and many more.

Today, Paramount works with the finest in motion picture talent, including JJ Abrams, Michael Bay, the Coen brothers, Steven Spielberg, Martin Scorsese, and many more. We launched the hugely entertaining *Transformers* series of films, scared audiences with *Paranormal Activity*, revitalized the *Star Trek* adventures, brought Justin Bieber to 3D screens, and left George Clooney *Up in the Air*.

Films produced or distributed by Paramount this year received more Academy Award nominations than any other studio, including ten nominations for *True Grit* and Best Supporting Actor and Actress awards for *The Fighter*.

In addition to our own films, we distribute the wonderfully creative films of Dreamworks Animation, including *How to Train Your Dragon*, *Kung Fu Panda*, *Madagascar*, and the saga of *Shrek*. We also distribute Marvel's *Iron Man* and the upcoming *Thor* and *Captain America*.

The distribution of our films creates jobs and tax revenue in all fifty states – ranging from substantial marketing expenditures to employment at movie theaters (including food and beverage sales jobs and revenue) to retail jobs involved in the distribution and retail sales of DVDs.

But it is often overlooked that motion pictures are shot in locations from coast to coast, creating jobs, supporting small businesses and generating significant revenue and tax dollars all across the country.

True Grit was shot in Texas and New Mexico, adding an estimated \$16.3 million to those local economies; *The Last Airbender* was shot in Pennsylvania, adding an estimated \$72 million to the local economy.¹

Those are just two examples. A new version of *Footloose* has just been filmed in Georgia, *The Fighter* and *Shutter Island* were both filmed in Massachusetts, *She's Out of My League* was filmed in Pennsylvania, *Benjamin Button* was filmed in Louisiana (as was much of *Forrest Gump*); *Up In The Air* was filmed in St. Louis with additional filming days in Detroit, Miami and Las Vegas; *Tropic Thunder* was filmed in Hawaii.

¹ Those figures include hotel room nights, local crew, local actors and extras, per diem paid to non-locals, location fees, stage expenses, office rentals and supplies, security expenses, communications expenses, equipment rentals, vehicle rentals and transportation expenses, catering and food expenses, art department and wardrobe expenditures, construction costs, state and local sales and use tax, city wage taxes (Philadelphia), hotel tax, state withholding taxes on resident hires and non-resident hires, and miscellaneous (such as prop expenses, shipping expenses, location scouting, local publicity, and hair and makeup expenses, among others).

The production of a single Paramount motion picture can employ from 100 to 5,000 workers, not including extras. [See Attachment 1] For example, a small-budget film like *She's Out of My League* employed 440 workers; a mid-budget film like *Shutter Island* employed 1,573 workers; a big-budget film like *Transformers* employed 4,654 workers. These numbers reflect only the individuals hired specifically to work on the film and do not include the many regular full-time Paramount employees who also work on the films, including production employees, post-production employees, accountants, lawyers, human resources, and support staff.

• **The Promise of Technology: Fulfilled or Unfulfilled?**

The motion picture industry is exploring and implementing many new ways to get our content to consumers via new media platforms that satisfy consumer desires. We embrace the ultimate transition from a hard goods era to a digital delivery era. With that transition comes enormous legitimate business risk, but we are not risk adverse. We take a multi-million dollar risk every time we greenlight a movie. Online piracy, however, adds an additional layer of threat which makes that transition extremely difficult to manage.

At Paramount Pictures, we believe in coming years consumers will increasingly choose to view our motion pictures via authorized online and mobile distribution.

Paramount currently licenses more than 200 online digital distribution platforms across more than 70 countries covering more than 750 films in more than 25 languages. [See Attachment 2] And we are not alone in making our content available to consumers across a wide array of online platforms; consumers can now access television shows, music, and books in a variety of exciting new ways.²

But none of these innovative initiatives can succeed, and the motion industry cannot survive, if the current situation is permitted to continue. This is a situation in which stolen copies of every current film are available online, in most cases commencing during the very same week in which the film opens in theatres. And those stolen copies are often distributed on a revenue-generating basis, diverting consumer spending from the creators and legitimate distributors of the content into the hands of criminals – often outside the United States – who do not create American jobs, do not reinvest that money in creating new productions, and do not pay U.S. taxes on that money.

I refer to this as the “online shadow economy.”

The same technology that will enable consumers to enjoy motion pictures and other forms of copyrighted content in new and exciting ways is being used in the online shadow economy to steal that content. Unless the rule of law is effectively applied to online distribution platforms – and it currently is not – that technology will not reach its promised potential. The result will be a substantial decrease in the number of motion pictures that are produced, which in turn means fewer American jobs, smaller tax

² We are engaged in a collaborative effort with other content producers, software companies, and equipment manufacturers on a project called UltraViolet, which will enable consumers to enjoy the content they purchase across a variety of devices and locations without the need for making multiple purchases. <http://www.uvvu.com/>

revenues, a decrease in the positive contribution of film exports to the U.S. balance of trade, and a substantial narrowing in the type of motion pictures that will be produced.

• **The Rise of the Online Shadow Economy, its Effect on Jobs, and its Economic Impact**

Paramount and the other studios' ability to continue creating memorable films is now being jeopardized by the alarming rise of a profound online shadow economy.

This alternative economy is an illegal parallel economy that has developed alongside the legitimate economy for the online distribution of our motion pictures. This activity is not limited to feature films – it blankets all forms of intellectual property, including television productions, music, books, games, software, and educational testing materials. And it applies as well to hard goods including apparel, handbags, toothpaste, car parts, airline parts, and fake and substandard pharmaceuticals to name a few.

In this online shadow economy, every single film we distribute is promptly stolen and then illegally made available online without creating any jobs, without reinvesting any revenue in the creation of new films, without paying taxes, and without contributing to the U.S. economy. Instead, much of that stolen revenue merely enriches foreign nationals.

Until recently, a simple technological barrier provided some degree of insulation for creators and distributors of motion pictures from the economic ravages created by the illegal economy: consumers could not easily watch stolen content on their living room TV the way they could with DVDs.

That barrier is now disappearing. New television sets can offer built-in internet access, and internet access can be added to all other television sets with a simple and inexpensive plug-and-play interface device. [See Attachment 3] Consumers are no longer limited to watching stolen films on computer screens. Now, with the wave of a remote control, everyone can have direct access to illegal content on their living room television. Moreover, the rise of iPad-style applications will make it even easier to bring the iPad experience to your television set. [See Attachment 4a-b]

We are excited about and embrace the new legitimate distribution models that technology is opening up, but we also recognize that those who profit from the online shadow economy will siphon away those opportunities if left unchecked.

While it may be popular in some quarters to blame the victim, claiming that the rise of this parallel economy is the fault of content owners because of pricing or distribution patterns, the truth is that no business, no matter how innovative, nimble, or creative, can compete with a shadow economy that offers consumers high-quality distribution of the exact same goods at no cost or nominal cost.

The harm caused by the shadow economy inflicts severe damage on the U.S. economy during a time at which the country can least afford to bear that harm. Research has indicated that industries nurtured and supported by copyright represent approximately 6% of America's GDP – that's nearly \$1 trillion a

year in business and 5.6 million jobs. When supportive industries are included, that number rises to more than \$1.5 trillion, which was 11% of GDP in 2006-2007.³

Certainly those numbers are staggering and I would like to share with you the perspective that I see on an operational level at Paramount.

While box office revenues remain strong – which indicate that we are still creating movies people want to see – DVD and other forms of home entertainment sales are declining. Why pay to buy a DVD when any film can be streamed online at any time at no cost or nominal cost? And the negative impact is clear. Theatrical exhibition contributes roughly 25% of the total revenue of a typical film; DVD contributes 50% and television distribution (subscription TV, pay-per-view, and free TV) and online distribution contribute 25%. [See Attachment 5] As DVD sales constitute a smaller share of the total revenue of a typical picture, the break-even point on the typical picture becomes more remote. Simply put, this means that the multi-million dollar investment that studios make in producing and developing films cannot be recouped, if ever, until further and further into the distribution chain. [See Attachment 6]

The number of films being produced has shrunk significantly, particularly with regards to mid-budget and independent films. [See Attachment 7] Fewer films means fewer jobs across all 50 states in production and in distribution, less tax revenues, and less contributions to workers' health and retirement plans.⁴ And it means less variety in the types of films that get made – as the studios aim to mitigate their losses from piracy, we will see a continued trend towards big-event tent pole and low-budget films, but far fewer mid-range budget films will be offered to audiences because those films will have the smallest odds for breaking even in a world of diminished non-theatrical revenue.

It is easy to see how even if only a portion of that online shadow economy was returned to the legitimate economy, the positive economic impact would be enormous.

• The Chronology of a Pirated Film

With very few exceptions, films enter the illegal economy when they are camcorderd in movie theaters – often during the opening week of the film.

A few years ago, a camcord copy was a shaky, out-of-focus product with a soundtrack obscured by rustling popcorn boxes and other crowd noise. Today, in the era of digital camcorders with image stabilization and audio tracks copied from the hearing-impaired audio systems present in most theaters, camcorded copies are now of extremely high quality.

Once even a single camcorded copy of a film appears on the internet, it is soon coupled with audio tracks in a myriad of languages.

³ International Intellectual Property Alliance (IIPA) study, June 2009.

⁴ The health care and pension plans for actors, directors, electricians, painters, plasterers, laborers and writers are funded in part from residuals paid by the studios based on DVD sales. As those sales continue to lose ground, the impact on those plans will be devastating.

A few months later when the film is scheduled for release on DVD, a perfect digital copy is ripped from the DVD and uploaded onto the internet, replacing the earlier camcorder copies.⁵

Once a single stolen copy appears online, it rapidly becomes entrenched throughout the illegal ecosystem. For example, within six months after *IRON MAN 2* was first camcordered in a theater, it was available in 12 languages, there had been more than 15 million peer-to-peer downloads, and more than 153,000 links were available in cyberlockers⁶ for download or streaming.

This problem is not limited to recent releases; most major library titles from all of the studios are also readily available online in perfect digital via copies from DVDs.

The motion picture studios are taking a broad array of actions in response to illegal online trafficking in our films. We deploy technologies which allow responsible online services to filter out illegal content. We send take-down notices to responsible online services. We release our films on a wide variety of consumer platforms including many legitimate online services.

But when it comes to rogue services, we lack the tools that could make a difference. The PirateBay website is one of the most notorious traffickers in stolen content. Not only do they refuse to filter out stolen content, they outright reject – in writing – requests that infringing content be taken down from the service. [See Attachment 8.]

• Access to Stolen Films Is Now Just a Few Clicks Away

In the past, accessing a stolen copy of a motion picture required a certain degree of technical savvy and often required downloading specialized software. In the past, consumers were fully aware that they were accessing unauthorized infringing material.

Today, an online search for movies leads consumers not to one of the many legitimate online services but instead leads them directly to a streaming copy of the stolen film. And, with the widespread acceptance of credit cards and PayPal payments, coupled with the widespread presence of advertisements for well-known products, consumers may not know the difference and may not realize that they are watching stolen content.

For example, if you type “watch” into Google, as soon as you type “wat” (which could be a search for “water”) Google auto-fills the search term “watch movies”. That search brings up a list of sites trafficking in stolen content. [See Attachment 9] The same happens if you type in “stream” (which

⁵ The ripping occurs weeks prior to the public release date, taking place as soon as we ship the DVDs into the supply chain for distribution to retail outlets.

⁶ Cyberlockers are data storage facilities – equivalent to the hard drive on your computer but accessed through an online connection. There are many legitimate uses for cyberlockers – including backing-up computer hard drives and facilitating the sharing of large data files. Unfortunately cyberlockers are also used for the storage and distribution of stolen copies of motion pictures, music, books, games, and software. A motion picture which is stored on a cyberlocker can either be downloaded or streamed.

could be a search for “stream of consciousness”): Google suggests the search term “stream movies” and then returns a long list of sites trafficking in stolen content. [See Attachment 10]

If you click (1st click) on the first site suggested by Google, it brings you to a linking site which looks as legitimate as iTunes or Netflix. [See Attachment 11a] When you click on a movie (2nd click) it brings up a list of stolen copies of the film accompanied by users’ ratings of the quality of the stolen copy. [See Attachment 11b] With another click (3rd click), you are then taken to a landing page [See Attachment 11c]; with another click (4th click) you are taken to the film itself. When you click on the film (5th click) the movie begins to stream. [See Attachment 11d]

With just five clicks following a basic Google search, anyone can be streaming a stolen copy of almost any film. And it should be noted that the search term used in Google was not “watch stolen movies”, “watch pirated movies”, “watch free movies”. It was merely “watch movies” or “stream movies” – searches which should have returned results for iTunes, Netflix, Amazon, or one of the many legally authorized online distribution services.⁷ Instead the search results usher consumers – including consumers who are looking to pay for content – into the shadow economy.

• **Traffickers in Stolen Content are Diverting Millions of Dollars From the Legitimate Economy**

Trafficking in stolen content has become big business for criminals.

Twenty cyberlockers account for 96% of all infringing copies of Paramount films found on all cyberlockers. These twenty cyberlockers receive a total of 177 million unique monthly visitors.

To give an idea of the popularity of these twenty cyberlockers, one (MegaUpload) is currently ranked as the 51st most popular website by the Alexa popularity rankings.⁸ By comparison, MySpace is 70th, ESPN is 77th, the New York Times is 84th. Even more telling, Netflix is 94th.

All twenty cyberlockers have used incentive programs to encourage the uploading of stolen copies of motion pictures. [See Attachment 12] When one of the twenty discontinued its incentive program in response to legal pressure in Germany, its traffic dropped by 30% at the same time the traffic to the other nineteen increased by 65%. [See Attachment 13]

None of the twenty implement the necessary simple technological steps that can be used to filter out the distribution of stolen motion pictures.

The reason is obvious: enormous profits can be made trafficking in stolen motion pictures. A business analysis of one of those cyberlockers estimates a *minimum* annual profit of \$41 million to \$304 million.⁹

⁷ See Attachment 2 for a sample of those authorized online distribution platforms.

⁸ The Alexa rankings are a form of Nielsen-type rankings for websites based on the number of unique visitors to the site.

⁹ We arrived at this estimate by assuming that the cyberlocker has merely a 1% to 5% subscription rate (the cyberlocker offers a tightly limited free sample of usage beyond which a subscription is

That is millions of dollars siphoned off from the creators and legitimate distributors of the content, siphoned away from employment for American workers. That is millions of dollars on which no U.S. taxes are paid, and which undermine the positive U.S. balance of trade in copyrighted content.

• The Peril to Consumers

In addition to the loss of American jobs, loss of American tax revenues, and negative impact on the U.S. balance of trade, the lack of effective rule of law on the internet poses a threat to consumers.

Many of the online services that traffic in stolen content can appear indistinguishable from legitimate services. [See Attachment 15a-d] The illegal services often accept major credit cards and PayPal [See Attachment 16a-c] and show advertising from major well-known brands. [See Attachment 17a-b] This creates a four-fold problem: it provides the revenue necessary for the traffickers to continue their activity, it leads consumers to believe that the service is legal, it exposes consumers to credit theft, and it deprives content owners and legitimate distribution platforms – including Netflix, iTunes, and Amazon – of revenue from consumers who are paying for online access to content.

Consumers are further lured into entering in financial transactions with trafficking online services through the unauthorized use of consumer protection logos such as McAfee Secure. [See Attachment 18]

In addition to being exposed to credit theft, consumers who engage in transactions with trafficking services unknowingly expose their computers to harm from spyware, malware and viruses. The threats arise both from downloading and from streaming, despite a perception that streaming is safer. [See Attachment 19]

• The Absence of the Rule of Law

The Digital Millennium Copyright Act (DMCA) established an effective regime for notice and take-down of individual infringing files. However a growing number of illegal sites merely replace removed files with new files of the same film, often automatically.

With any of the trafficking cyberlockers, individual files may come and go, but there is never a moment that stolen copies of *TRUE GRIT* are not accessible.

This same problem applies to search engines: they will take down tens of thousands of links to individual copies of stolen films (“torrents”) on the PIRATEBAY.ORG, while continuing to direct traffic to the PIRATEBAY.ORG website, which provides access to that never-ending avalanche of stolen files.

necessary), with a \$6 average subscription fee and 83 million monthly unique visitors. We used an estimate of 32 million daily ad impressions at \$1 - \$3 cost-per-thousand-viewers. On the cost side we estimated \$20 million for bandwidth charges plus \$7 million for storage (the two things the cyberlockers cannot steal) and \$3 million for overhead. At a 1% subscription rate the resulting profit is \$41 million; at a mere 5% subscription rate the profit is \$304 million. [See Attachment 14]

Legislation focusing on rogue online services is desperately needed to establish the rule of law on the internet. This is particularly true where rogue services force content owners into an endless process of whack-a-mole in fruitless efforts to remove illegal content. Foreign sites often pose an even greater challenge because they refuse to comply with obligations under the DMCA and it can be difficult or impossible to achieve jurisdiction over them in U.S. courts or in an effective foreign court system.

In the same way that department stores must cope with losses due to shoplifting, the motion picture industry will always be coping with losses due to online theft. But we need the necessary tools to address the fact that our all of our films are continually being offered online in the shadow economy. And we need search engines, credit providers, ad brokers, and ISPs to shift from an enabling mode to a mode of cooperating in thwarting theft. Among those players, we have had varying degrees of cooperation, with MasterCard stepping forward with the most positive and aggressive action. It appears that it may take legislation to shift many of the other facilitators away from a position of enabling online theft.

From the 1909 Copyright Act to the 1976 Copyright to the DMCA, other countries have looked to the U.S. for leadership in innovative copyright legislation that fosters creativity and development while protecting content and permitting creators of content to benefit financially from their creations.

We at Paramount Pictures are constantly being asked in other countries what the U.S. is doing to address this problem – particularly in light of the fact that the content industry is so enormously vital to U.S. jobs and the U.S. economy. Spain, for example, has recently passed legislation providing for the expedited blocking of sites that refuse to remove infringing content. Similar provisions are being proposed by Italian regulators, and the UK government is exploring site blocking options. At the EU level, the European Commission’s review of the EU Enforcement Directive is likely to consider an EU-wide requirement on member states to adopt measures to counter online piracy. Rogue service legislation would provide an opportunity for the U.S. to add its leading voice in reasserting the rule of law on the internet in order to protect content and consumers and to encourage the growth and development of both content creation and new delivery systems for online and mobile distribution of content.

Conclusion

The Copyright Clause of the Constitution (Article I, Section 8) empowers Congress to secure to authors and inventors the exclusive rights to their writings and discoveries. Today, those rights are anything but secure.

It is incumbent on Congress to find ways to restrict the online shadow economy and to once again level the commercial playing field and secure those rights.

Doing so will not only benefit the thousands of American jobs and millions of dollars in tax revenue that are currently being lost, but it will also allow the internet to fulfill its full commercial promise.

An apt analogy has been drawn to an earlier moment of transformation in American society. In the 1950’s, the Eisenhower Administration undertook one of the most massive infrastructure projects in our nation’s history - the creation of the interstate highway system.

The advent of the interstate highway system transformed how we did business, traveled, and conducted our daily lives. But unlike the internet of today, the highways were built and operated with a set of rational guidelines for users. Speed limits saved lives, weight limits saved maintenance costs. New forms of law enforcement, such as the Highway Patrol, were created to ensure that the rules were obeyed. The FBI and other law enforcement agencies stepped up efforts to deal with interstate crime. As a result, as interstates flourished, so did the economy. Over the course of its first four decades of existence, the interstate highway system is reported to have been responsible for fully one-quarter of America's productivity growth.

The internet will not reach its potential for being a vehicle for creativity, for job creation or for revenue generation, if the rule of law is not effectively applied. We are at a decision point: are we going to allow the illegal economy to flourish, destroy American jobs, gut American tax revenues, undermine the health and pension plans of American workers, and restrict creativity? Or are we going to take steps to curtail the shadow economy and thereby enable the legitimate economy to compete and thrive on a level playing field?

The internet has the potential to be the future for the motion picture industry or the undoing of that future. This is why it is so important that Congress take action now – before irreparable harm is done – to enable legitimate businesses to flourish in the online world creating American jobs and tax revenue and expanding choices for consumers.

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