THE UNIVERSAL MUSIC GROUP/EMI MERGER AND THE FUTURE OF ONLINE MUSIC

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS OF THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

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THE UNIVERSAL MUSIC GROUP/EMI MERGER
AND THE FUTURE OF ONLINE MUSIC

THURSDAY, JUNE 21, 2012

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, COMPETITION
POLICY, AND CONSUMER RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:18 p.m., in room
SD–226, Dirksen Senate Office Building, Hon. Herb Kohl, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. HERB KOHL, A U.S. SENATOR
FROM THE STATE OF WISCONSIN

Chairman KOHL. Good afternoon. Sorry to be a little late this
afternoon. We had some votes to complete.

In recent years, the music industry has undergone a radical
transformation as consumers embrace new digital music tech-
nologies. The transformation is as revolutionary today as the
Gramophone, radio, and recorded music were a century ago.

The deal before us today is just one example of this trans-
formation. EMI is being sold in two parts—to Universal and to
Sony—so that there will only be three major record companies re-
main. Today we meet to consider the sale of EMI’s recorded
music business to Universal and its impact on competition, artists,
and consumers.

As recently as 20 years ago, virtually all consumers obtained
their music by going to their local record stores to buy records or
CDs, often after hearing the music on the radio. Today the market
is very different. About half of all music revenue comes from digital
sales over the Internet, from downloading songs and albums via
iTunes, or listening to an online music subscription service such as
Spotify, to give only two examples.

Recording artists can reach consumers directly over the Internet
without ever signing a deal with a record company. Most record
stores have closed as a result of the new online services. For those
consumers who still buy physical CDs, they do so primarily at large
chains such as WalMart or Target or by ordering over the Internet
on a website like Amazon. And the music industry faces ongoing
challenges from illegal downloading of music over the Internet.

In this brave, new world for the music industry, Universal and
EMI argue that this deal should not concern us. They contend that
the market shares resulting from the merger should not concern us and that the power to set prices is in the hands of online distributors or the large chain retailers with whom they must deal. And the ongoing problem of piracy, they argue, effectively constrains their ability to raise prices when consumers can easily get music for free via illegal downloads.

Nonetheless, we need to closely examine whether reducing the number of major record companies to three and giving Universal as much as 40 percent of the music business by some measures will adversely affect competition. Concerns are especially strong with respect to the market for online distribution. Will Universal’s music catalogue be so large as to make it a gatekeeper that can make or break any new online service and allow it to prevent new competitively priced services from launching?

We must carefully scrutinize what this merger will mean for consumers who buy music on physical CDs, still half of all music sales revenue. In almost all industries, reducing the number of competitors from four to three expands the market power of the remaining companies and increases the risk of higher prices. Why shouldn’t these same principles apply to the music business? Moreover, will the three remaining record companies be able to obtain the lion’s share of floor space and promotions in retail stores, thereby crowding out the smaller competitors?

We must be mindful of the possible harmful effects on independent labels and artists. As in so many creative industries, innovation and new forms of music often come from those artists not signed to major record companies. We need to be careful to ensure that this consolidation does not impede the ability of independent record labels to compete or place undue barriers to the emergence of new, innovative, and diverse talent in the music industry.

So our examination of this transaction leaves us with more questions than answers as we begin today’s hearing. While we recognize that the music industry has gone through enormous changes and challenges in recent years, nevertheless we are mindful of the basic principles of antitrust and the need to maintain competition in this industry for both consumers and artists.

We look forward to the testimony of our panel of witnesses on these issues, and we are very pleased to be with you today.

Senator Lee, any comments?

STATEMENT OF HON. MIKE LEE, A U.S. SENATOR FROM THE STATE OF UTAH

Senator Lee. Yes, thank you, Mr. Chairman. Thanks to all of you for joining us today.

The recorded music industry is both a staple of our popular culture and an essential element for our economy. The 40,000 businesses involved in the United States music industry employ over 100,000 people, including artists, managers, technicians, and record label staff. And music can be big business. Estimated revenues for the sale of recorded music in America now exceed $7 billion each year.

The music industry is also changing rapidly. Last year, digital sales surpassed physical sales for the first time in history. Online retail and digital distribution services provide customers with un-
precedented access to lesser known artists who might otherwise have been unable to obtain a recording contract. Digitization has opened the door to a new and diverse world of innovative platforms and modes of competition.

But the rise of digital music has also made illegal pirated recordings readily accessible to anyone with a computer who has an Internet connection. The future of online music is bright but uncertain. Although Internet-based radio and other music services are growing at an impressive pace, some suggest that the Copyright Royalty Board’s rate-setting process is broken and should be reformed. Whatever the nature of any such reforms, enforcement of our antitrust laws must be oriented to help foster innovative technologies and enhance consumer welfare.

As the music industry attempts to traverse a changing technological and competitive landscape, some consolidation may, of course, be expected. It, therefore, came as little surprise when Universal Music Group announced its intention to acquire EMI’s record label. This announcement followed the 2007 transfer of EMI, which has suffered from sharply declining market share and enormous debt, to a private equity firm and eventually to Citigroup.

Many industry observers welcome the prospect of Universal taking full advantage of EMI’s artists and catalogue, helping to revise an industry in the midst of some decline. Universal’s productive use of EMI’s assets promises efficiencies that an equity firm or a bank is unlikely to achieve.

At the same time, some competitors and public interest groups note that a Universal/EMI merger would reduce the number of major labels from four to three and give Universal a larger market share than either of the remaining majors.

Critics fear that a combined Universal/EMI could leverage its market power to increase prices to retailers and to consumers. Some worry that the combined company may stifle innovation in emerging digital distribution models by refusing to license its catalogue to inventive services.

Others also fear that a dominant label might seek to exclude competitors from accessing key promotional space in retail and digital distribution services.

These concerns underscore the complex, evolving nature of the music industry and the need for careful analysis of the relevant markets and the manner in which market power might be exercised. I am hopeful that this hearing will provide insight into the competitive landscape of the recorded music industry.

Mergers play an essential role in our economy and should be permitted where they do not harm consumers. Mergers can bring to bear superior managerial skills, allow for more productive use of underutilized assets, and result in economies of scale, reduced costs, improved quality, and increased output.

The potential for mergers generally provides positive incentives for industry managers who recognize a need to maximize profits or face consolidation. Likewise, innovators know there is an acquisition market for the businesses that they create.

Under most definitions of the relevant markets, this merger will result in a significant degree of concentration. As the merger guidelines make clear, however, this is not the end of the analysis, and
the merger may proceed where other competitive factors counteract
the potentially harmful effects of increased concentration.

Universal and other proponents of the merger assert that there
is reason to believe such competitive factors are present in the var-
ious markets for recorded music. Music retailers wield tremendous
market power, with Apple and WalMart alone accounting for up to
60 percent of sales. This countervailing market power may well
protect against labels' successfully raising marginal prices.

The nature of the modern music industry may provide an addi-
tional protection against anticompetitive effects. The prevalence
and affordability of technology has increased the ease and entry
quite substantially, resulting in greater access and an increased va-
riety of access points, whether YouTube, MySpace, or iTunes, for
artists and for independent labels. In fact, independent labels now
account for approximately 30 percent of music ownership.

Finally, at least at present, we cannot ignore the effect of pirated
music. The threat and the prevalence of piracy surely impact deci-
sionmaking throughout the legitimate recorded music industry and,
therefore, must be considered as part of any comprehensive anti-
trust analysis.

Government regulators should be wary of intervening in rapidly
changing and innovative markets. The music industry has experi-
enced much turmoil as it struggled to adjust to changes in tech-
nology, pricing models, and consumer expectations. Gone are the
days when consumers bought entire albums in order to acquire just
a single song. Also gone are the days when consumers purchased
the same album a second time simply to update their libraries to
the latest format. Today record labels and the artists they rep-
resent have their work stolen and shared freely over the Internet.
Every year consumers demand more music for less money. As the
music industry grapples with these and other challenges, Govern-
ment regulators ought to be careful not to prohibit reasonable busi-
ness judgments and decisions that may lead to efficiencies and pro-
ductive solutions.

I look forward to hearing the testimony today, and I thank the
witnesses for coming.

Chairman KOHL. Thank you, Senator Lee.

Now I would like to introduce our panel of witnesses. First to testi-
fy will be Lucian Grainge, who is chairman and CEO of Universal
Music Group since 2011.

Next we will be hearing from Roger Faxon, who serves as the
CEO of EMI Group and first joined that company in 1994.

Our third witness will be Irving Azoff, executive chairman and
chairman of the board of Live Nation Entertainment, and chairman
and CEO of Front Line Management Group.

Next we will be hearing from Edgar Bronfman, Jr., director and
former chairman of Warner Music Group and former executive vice
chairman of Vivendi/Universal.

Next we will be hearing from Martin Mills, founder and chair-
man of Beggars Group, who has served as vice chairman of the As-
sociation of Independent Music.

Finally, we will be hearing from Gigi Sohn, president and CEO
of Public Knowledge and a member of the Advisory Board of the
Future of Music Coalition.
We thank you all for appearing at our Subcommittee hearing today. I ask all of you now to rise and raise your right hand as I administer the oath. Do you affirm that the testimony you are about to give before this Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. GRAINIGE. I do.
Mr. FAXON. I do.
Mr. AZOFF. I do.
Mr. BRONFMAN. I do.
Mr. MILLS. I do.
Ms. SOHN. I do.
Chairman KOHL. Thank you very much.

We will start now with you, Mr. Grainge, and we are looking forward to your statement. We request that your statement be limited to 5 minutes. Mr. Grainge.

STATEMENT OF LUCIAN GRAINIGE, CBE, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, UNIVERSAL MUSIC GROUP, SANTA MONICA, CALIFORNIA

Mr. GRAINIGE. Thank you. Good afternoon, Chairman Kohl, Ranking Member Lee, and members of the Subcommittee. My name is Lucian Grainge, and I am the chairman and chief executive of Universal Music Group. It is an honor for me to be here today, and I welcome the opportunity to discuss both the issues affecting the music industry at large together with our proposed acquisition of EMI’s recorded music business.

I count myself lucky to have spent my entire professional life in and around music. Music connects us, and it inspires us. I started in the music industry 33 years ago as a talent scout. I was a talent scout then, and I am a talent scout now.

As well as continuing to identify great artists, I also scout for writers, producers, creative executives, startups, entrepreneurs, and digital platforms.

The music business is reinventing itself on a daily basis, and this reinvention has not always been kind to us. The industry is half the size it was in 2001, and I am sure that Roger, Edgar, Irving, and Martin will agree that we have all managed our business through a very difficult decade. So it is invigorating to talk about the future this afternoon, to talk about the potential for growth, the commitment to digital expansion, and a fresh, positive energy.

The mere concept that we can discuss growth is not something we have been able to do for a long time. I believe that Universal’s proposed acquisition of EMI sits at the heart of this positive move forward. Roger Faxon has done a remarkable job with EMI under challenging circumstances, and the company is now on a sounder footing. We propose to make a courageous investment in EMI to sign artists, develop them, and invest in future technologies and distribution models.

Digital is our future, and we are wholeheartedly committed to supporting every viable legal venture that gives consumers what they want, when they want it, and on the devices that they want.

Today fans learn about music on blogs and social networks and listen to it on many services, including, for example, Cricket’s Muve, Rdio, and Spotify.
Retailers have the ability to find out what consumers want as a result of this new technology. We cannot control consumers’ access to music or artists’ access to consumers. Technology has empowered artists and consumers, and I am proud that Universal has well over 100 digital music partnerships in the United States alone.

The proposed acquisition comes at a time when all the competition in this industry is as fierce as I have ever known it. All labels of whatever size see opportunities that simply would not have existed even months ago. This competition is a good thing, and it requires that we make the right strategic moves in order to protect and promote our talent base.

Let me give you an example of how the landscape has changed. Ten years ago, independent labels were 23 percent of the market. Today they have grown to 30 percent. Digital has lowered the barriers to entry. Technology and the Internet have enabled anyone to create music, market music, and distribute music.

Reinvigorating EMI with Universal’s resources and innovation is not only good for our company but good for artists, consumers, and everyone who is connected with music.

As the artists create the market, Universal is also delighted to have the support of the unions SAG-AFTRA and AFM, both of whom represent America’s recording artists and professional musicians. Universal will always have one very clear focus: to promote music in as many ways as possible.

So thank you for allowing me to explain why I am so excited about the future of this industry, and I look forward to a productive discussion with all of you.

[The prepared statement of Mr. Grainge appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Grainge.

Mr. Faxon.

STATEMENT OF ROGER C. FAXON, CHIEF EXECUTIVE, EMI GROUP, NEW YORK, NEW YORK

Mr. FAXON. Thank you, Mr. Chairman, Ranking Member Lee, members of the Subcommittee. I am Roger Faxon, and as the Chairman has said, I am chief executive of the EMI Group, and I am pleased to join you today to discuss the Universal Music Group’s proposed acquisition of our recorded music division.

To appreciate the competitive implications of this transaction, I think it is important to place it in the context of the market for recorded music as it is today, and not as it may have been in the past. Without a doubt, the music landscape has changed beyond all recognition from where it was even 10 years ago.

In that time, overall industry revenues have more than halved, even as digital revenues have soared. The forces that have produced this decline have substantially shifted the impact of record company consolidation, on both consumers and the wider music business. I would like to take you through why I believe that to be so.

As digital exploded, the CD fell through the floor. Specialist retailers, which were the backbone of our industry, all but became extinct. For the vast majority of the thinning ranks of retailers that...
remain, music is not at the center of their offering. But they are
central to record companies and the careers of their artists. So, in-
variably, it is they, not the labels, that are in control. It is the re-
tailers who decide which albums they stock and what commercial
terms they will take.

Retail concentration is even more pronounced on digital plat-
forms. Between the iTunes and Amazon services, you have two
players accounting for 90 percent of the download business and
over 80 percent of all digital revenues. In this environment, pricing
again does not sit with the gift of the record companies, regardless
of size or market position.

Digital distribution has created a music meritocracy. There is no
limit to the amount of music that can be stocked. That means any
band, budding or established, can have their music distributed on
digital platforms. Major record companies, if they ever were, are no
longer the gatekeepers.

In this meritocracy, good music rises to the top. The skill is in
finding that music and helping to connect it with an audience, and
that skill is not confined to one company or group of companies.

The Internet has also democratized music promotion. The explo-
sion in media has taken promotional power away from the editors
and radio program directors and put it firmly in the hands of music
fans through Facebook, Twitter, YouTube, and a myriad of other
sites and services—all essential to an artist’s ultimate success.

These fans do not care about market position of an artist’s record
company. They care about the music and whether it is any good.

And radio stations are focused on playing only the music that their
extensive callout research tells them will connect with the highest
possible audience, irrespective of its source. Again, it is the music
that matters, not the source.

Technology has significantly reduced the cost of entry for new
music companies. As a result, the market is more crowded and
competitive than it has been in my experience. So record companies
cannot control consumer pricing, do not control access to con-
sumers, cannot exert control over promotional platforms or music
discovery tools that fans use, and they have to compete with the
vastly increased number of alternative paths to market for artists.

If there ever were antitrust issues implicated with label consolida-
tion, it seems to me they are not present today.

As a result of all this change, the focus of the music industry has
returned to where it should be—on helping artists develop the most
compelling music and working with them to ignite passion for it in
their fans. And I think we are doing a very good job of that.

But we also have to assure that the creators of that music are
properly rewarded for their contribution. And there we are not
doing as well as we should. The ambiguity and unenforceability of
our intellectual property laws is failing our creators. Individual
rights holders are no longer able to protect their music, ISPs are
not held responsible for their actions, and safe harbor provisions
designed to encourage innovation are instead being used as a
shield by bad actors seeking to build their own business without
compensating the creators whose music underpins those new busi-
nesses.
Technological and musical innovation are not mutually exclusive. Content created by great artists and songwriters can drive consumers toward new ventures, and exciting new platforms and products can open up a wider market for the works of creators. But our institutions have allowed the balance to shift too far in favor of big technology. The impact on our creative community has been devastating and will only worsen if the scales continue to tip unchecked.

Music touches us in a way that nothing else can. For me it has been an absolute privilege to be able to represent some of the greatest artists this world has ever seen. Yet without a solid framework of intellectual property rights to underpin that creativity, we do not just threaten labels or jobs, but America’s ability to nurture the next Jay-Z, the next Beach Boys, the next Norah Jones. That will not be the fault of any merger or acquisition. It will be the fault of our own unwillingness to stand up to protect one of the greatest cultural strengths this country has to offer.

Thank you.

[The prepared statement of Mr. Faxon appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Faxon.

Mr. Azoff.

STATEMENT OF IRVING AZOFF, EXECUTIVE CHAIRMAN AND CHAIRMAN OF THE BOARD, LIVE NATION ENTERTAINMENT, INC., AND CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FRONT LINE MANAGEMENT GROUP, LOS ANGELES, CALIFORNIA

Mr. AZOFF. Thank you, Mr. Chairman, and thanks to the Committee for having me here today.

I grew up in Danville, Illinois, a mid-American town with all-American ideals, and briefly attended the University of Illinois. For more than 43 years in the music business, I have focused on one thing: serving artists. The music industry I joined was a vibrant, emerging, and entrepreneurial business whose format of choice was vinyl. Throughout all the choices—vinyl, 8-track, cassette, and compact disc—one thing remained constant: the power of the record label. The emergence of the Internet has changed that.

I work with acts big and small, some that are household names and some who should be but just have not yet gotten there yet. Let me be very clear. None of them have to sign to a major label anymore. Majors cannot sign every act, and the door is open for many others to do so.

In fact, independent labels are capturing more and more market share every year. Bon Iver won the Grammy for Best New Artist this year. Esperanza Spaulding won last year. And Mr. Mills’ XL has brought us the biggest selling artist of 2011 in Adele.

Approximately 40 percent of our artists are not even on labels. I have no doubt that labels add value, but you just do not have to have one in a world where artists can deliver an album direct to fans themselves. It is a little like hiring an interior decorator to redo your house. The experience and results can be great, but some acts enjoy and prefer to do it on their own and put their own imprint on things. With services like iTunes, CD Baby, Top Spin,
Reverb Nation, Pro Tools, Facebook, Spotify—you name it—artists can do everything themselves on their own very professionally.

It used to be that bands could not make a professional album without the backing of a label. Labels used to be THE gatekeepers to fans. But today those barriers have been blown away. The new gatekeepers are the fans. Facebook and other social media make fans the essential promotional power. If a fan “likes” a song and tells a friend or two or 10,000, an artist is on their way. The power today rests with consumers, not record labels. So while the Internet has brought challenges for many, it has also given bands opportunities, access, and control previously unknown to any generation of artists.

The reason a combined UMG/EMI is a good thing rests in the much bigger picture. Our industry has been turned on its head in the last decade. With all the great developments the Internet has brought us, the economics are still daunting.

Most musicians make a living today from touring, not record sales as they once did. And it makes sense, since consumers are not buying $15 CDs anymore, they are paying for a single track download from Amazon or iTunes or listening to ad-supported services that result in mere fractions of a penny-per-play being paid to the artist; or worse, still, they just go to a torrent site and get it for free. Late to embrace the Internet, labels are playing catch-up. But any way you slice it, recorded music sales are still the core of a label’s business model.

Those who speculate about the demise of competition simply do not live in the hyper-competitive music world that I see every day. Competition is fierce between the major labels and fierce between the majors and indies. Competition is fierce as mobile services vie against one another and against Apple.

As for the brouhaha around this deal, Mr. Bronfman has been talking about combining Warner and EMI for the better part of a decade. The entire industry expected it to happen, Wall Street expected it to happen, journalists expected it to happen. Warner had a chance to outbid Universal in this process but chose not to. Now they regret their decision and are spending millions to fight this deal. Well, I do not think the Government should step in to give them another bite at the apple. That is not how our free economy works.

The fact is it would have been great if EMI could have made a go of it on its own. But the recession, piracy, and the facts surrounding Terra Firma and Citi combined to make that a pipe dream. The aura of uncertainty made EMI a risky place for an artist to sign. This business is about relationships and confidence that the team you sign with will be right beside you through the entire journey.

Uncertainty made it hard for EMI to compete. With Universal taking over and their commitment to resurrecting Capitol Records, there will actually be another record company for artists to explore if they want to. As I see it, it is not one less company—it is one more choice.

Bottom line, the people concerned that a combined UMG/EMI would have too much power really just do not get what has happened to the business over the last decade. Labels do not control
artists. Those days are gone. And no label in the world can control the supremacy of the modern music fan. The power shift has already taken place, and no one should worry for a minute that it rests with the labels any longer.

Thank you.

[The prepared statement of Mr. Azoff appears as a submission for the record.]

Chairman Kohl. Thank you, Mr. Azoff.

Mr. Bronfman.

STATEMENT OF EDGAR BRONFMAN, JR., DIRECTOR, WARNER MUSIC GROUP CORP., NEW YORK, NEW YORK

Mr. Bronfman. Good afternoon, Chairman Kohl, Ranking Member Lee, and members of the Subcommittee. I am Edgar Bronfman, Jr. I thank you for the opportunity to discuss why Universal's proposed takeover of EMI would do pervasive and permanent damage to digital innovation, to the music industry, and to the American consumer.

This merger would mean a world where one dominant company—Universal/EMI—sets the prices, terms and conditions for future digital evolution. Where that company would stand as gatekeeper between consumers and choice, and where digital innovation, one of the main engines of economic growth in this country, would be stifled solely for the benefit of one already large company that wants to become one dominant giant.

The Universal/EMI merger would reduce the number of music majors from four to three, one of which would be a super major, almost as large as the other two majors combined. Universal/EMI would control more than 50 percent of the Billboard Hot 100 titles and 42 percent of U.S. recorded music revenue. It is worth noting that a combined AT&T/T-Mobile would have controlled 43 percent of U.S. wireless revenue.

Universal/EMI's 42-percent share would be extreme by almost any standard. The media industry has never seen this level of concentration. Last year, the largest movie studio, Paramount, had about 20-percent market share, Random House was under 20 percent, and Comcast, the largest cable operator, had just over 20 percent of pay television.

Universal has tried to portray its market share as lower than it actually is by excluding labels that it distributes, but that is disingenuous. Owned and distributed market share is the metric Universal uses when talking to potential purchasers of its parent Vivendi’s shares. That is the metric it uses when it is seeking better economics from the Copyright Royalty Board. And, most important, that is the metric it uses when negotiating the terms of its digital deals.

When it comes to market power, especially in digital, where contracts include all music under distribution, there is no distinction between music that is distributed and music that is owned. Market share alone should make this merger suspect. But its profound ripple effects on digital innovation make it untenable because of music's unique role in the vibrant intersection between media and technology.
A decade ago, the Internet was assumed to be the music industry’s downfall, but we worked to reinvent ourselves, and last year U.S. music shipments increased for the first time since 2004. Digital downloads now account for over 50 percent of U.S. recorded music sales, overtaking physical sales for the first time. Even proponents of the merger acknowledge this inflection point in the U.S. The real winners are consumers, who now enjoy music in more ways than ever before. More consumers pay for music than for any other form of digital content, and we are still in the early stages of music’s digital transformation, with thousands of innovators dreaming up new opportunities. However, this proposed merger would dramatically impede, even derail, this transformation.

To understand the risk, let me share a story to illustrate how innovation comes to market. It is about an entrepreneur from a technology company who came to pitch Warner on a truly disruptive idea in 2002—a digital music “startup.” His company was a great innovator but had not seen significant growth in years. Yet this person believed he could reshape the way consumers experience music.

That entrepreneur was Steve Jobs. The company was Apple. The startup was iTunes.

Although Warner had only 17-percent U.S. market share, it was the first major to sign a deal with Apple. With that, Apple had the foundation it needed. It shopped the Warner deal around to the other majors and eventually got them all onboard. And the rest is history. iTunes has defined Apple’s content strategy, a key to its becoming the world’s most valuable company.

The iTunes story shows how important the current competitive balance among record labels is to enabling digital innovation. The sequential negotiation technique that Apple used in 2002 is used today by every digital startup. This process is critical for disruptive digital services that threaten the status quo. Entrepreneurs can reach terms with any of the four majors and build momentum from there.

Though even at its current large size some of Universal’s actions are dampening digital innovation, as the Wall Street Journal reported Wednesday, the market generally works today. However, this proposed merger would obliterate the fragile competitive dynamic that currently exists. With its 42-percent market share, Universal/EMI would unilaterally determine which services would live or die. It would be able to coerce ever more onerous terms, taxing entrepreneurs, jeopardizing innovation, constricting choice, and raising prices for the American consumer.

In sum, consumers are well served when no one company can dominate all decisionmaking for the market. Permitting this merger would grant Universal/EMI the power to serve as the sole arbiter of digital innovation. A broad group ranging from consumers to artists to digital startups, innovators and record companies alike have all expressed opposition to this merger so that a diverse and vibrant future can exist for music fans everywhere. We believe Universal’s attempt to buy its way to a position of unilateral dominance is inconsistent with such a future. We hope this Subcommittee will agree, and we urge you to do what you can to prevent this merger from being consummated.
Thank you.
[The prepared statement of Mr. Bronfman appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Bronfman.

Mr. Mills.

STATEMENT OF MARTIN MILLS, FOUNDER, BEGGARS GROUP, LONDON, UNITED KINGDOM

Mr. MILLS. I am honored to be here. Thank you.

Please forgive me if I use some strong words today, but having read the statements of those on the monopolists’ bench, I believe they are needed. I speak not just for myself but also for thousands of independent labels and artists worldwide.

Seven letters: C-O-N-T-R-O-L. It spells “control.” That is what this is about.

Do not believe them when they say the music market is now a Garden of Eden in which any young artist can become famous overnight without a label. That is simply not true. Ask them who these fortunate artists are.

Mr. Azoff says that 40 percent of his artists manage without a label. When I Google his company, I find the Eagles, Christine Aguilera, Kings of Leon, John Mayer, Van Halen, Jennifer Hudson, Miley Cyrus, Kenny Chesney, Kid Rock, Avril Lavigne, Aerosmith, and Jimmy Buffett—all on the front page. I do not recall any of them becoming successful without a record label. Do you? And all of them, I believe, released their last albums in association with a major. Whereas established stars may plow their own furrow these days, often with the benefit of services from a major label, any new artist needs a label just as much as Steven Tyler did. Even our artist Adele needed Sony’s strength in the U.S.A.

Do not believe them when they say market share is not market power. Market power is why they are doing this—the power to dominate digital services and impose their demands upon them, the power to leverage a disproportionately onerous deal, the power to squeeze out the competition, the power to impose what Universal wants on the consumer. You will see how they do that in the written evidence. It is all true.

Do not believe them when they say the independents represent a countervailing competitive force, the thousands of tiny, fragmented indies. Do not believe the 30-percent of the market figure for indies in this context. Two-thirds of that has digital rights controlled by the majors.

Do not think that the resulting Universal/EMI 40-percent market share figure is as simple as it looks. Universal/EMI’s share of hit Billboard’s Top 100 for the last year was nearly 70 percent when you include controlled shares and negative rights to block its repertoire. Indeed, looking at just last week’s Billboard’s charts, eight of the top ten singles will be post-EMI controlled by Universal. That is 80 percent.

When you hear Universal downplay its market share today, you should ask yourselves what market share do they insist on in their commercial negotiations, for splitting anti-piracy proceeds, for advances for music services. Very different. This is about Universal leveraging new acts who are already successful acts and obtaining
more than their fair share of the oxygen of exposure. Even today, contrary to what Mr. Faxon says, major labels have 92 percent of radio play.

Most great music, the music that changes tastes and lives, starts outside the mainstream, and that means on independent labels. Elvis Presley, Muddy Waters, R.E.M., Adele—they all did that. In fact, the economics of the majors these days means that signing artists without mass market potential makes no sense for them. If this transaction goes through, the next great artist may never be found.

With the kind of increased market dominance that Universal seeks here, it will completely control the shape of all new digital services. No one will be able to deny them. Look at their ability to raise prices of iTunes’ new music. Look at the Nokia “Comes with Music” service disaster and Universal’s hand in that. Look at the terms they were able to impose even on Google. It is all in the testimony.

Jean-Bernard Levy, the CEO of Vivendi, Universal’s parent, is reported to have said that the aim is to boost Universal’s bargaining power with mass market stores and a new breed of online distributor. Boost their power. Exactly.

Modern society sees unlawful monopolies as being bad, with good and with obvious reason. Some are worse than others. If airlines merge or soft drinks companies, is the effect on consumer choice that bad? Isn’t one seat or one soft drink pretty much the same as another? But that is certainly not the case with music. Music matters to people. It affects. It changes lives. It is human. It is personal. You cannot substitute a Katy Perry for a Lady Gaga for an Adele.

Yet in the world Universal seeks, great music will suffer, and we will be headed for a lowest common denominator music market with consumers having less choice and probably paying more.

Universal is a great company. Do not get me wrong. It has got great people. But there is big and there is too big. Give them the position of increased power and greater dominance that they seek, and they will exploit it. And specifically for a new company to start and grow in this environment, as mine did, will quite simply be impossible.

Please forgive my passion today, but not only do I absolutely believe what I say, I know it to be true.

Finally, Mr. Chairman, I must apologize. I have to leave at 3:30, which is the anticipated end time, but I welcome any questions before that point.

Thank you.

[The prepared statement of Mr. Mills appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Mills.

Ms. Sohn.

STATEMENT OF GIGI SOHN, PRESIDENT, PUBLIC KNOWLEDGE, WASHINGTON, D.C., ON BEHALF OF PUBLIC KNOWLEDGE AND CONSUMER FEDERATION OF AMERICA

Ms. Sohn. Chairman Kohl, Ranking Member Lee, members of the Subcommittee, thank you for the opportunity to discuss the sig-
nificant consumer harms the Universal Music Group and EMI Music merger would cause if allowed. I am speaking today on behalf of Public Knowledge and the Consumer Federation of America.

Online music and digital platforms they ride on hold tremendous promise for consumers and artists. Gone are the days when music fans could only listen to the latest album if they traveled to a physical record store, bought the album, and brought it back home to play on a stereo system. Technology now allows consumers to buy music at the click of a button and listen to that music on any number of personal devices. Artists also have been more empowered and capable to retain their independence by utilizing digital distribution platforms rather than going to a label.

Now, imagine that it is last year, 2011, a great year, and you are in the business of starting a digital music service in the United States. This chart represents the Billboard Hot 100 songs for 2011 as measured by sales and streaming activity. If you wanted to attract the consumers who are the most active music listeners, these 100 songs would have been the essential package. Without them, any avid music fan would see your service as incomplete, and you would not be able to attract the critical mass of subscribers necessary to make a profit. By the way, every single one of these artists is signed with one of the four major music labels.

Now, imagine a world where UMG and EMI had already merged, and they decided that they would withhold their songs from your digital music service. If that was the case, then this is what your digital music service library would look like. The playlist suddenly looks very sparse. After all, you would not have six of the top ten songs for 2011. You would not even have a majority of the top 100 songs. A combined UMG and EMI would own 51 of them. The fact is you just would not have a viable digital music service, and as a result, you would be beholden to the merged entity. That is the harm this merger presents to consumers.

Despite all of the improvements in technology and reduced costs of distribution, the music business is not immune to the exertion of market power. As more consumers demand their music through the Internet, this merged entity—a super label, so to speak—has the inherent incentive and ability to maintain dominance by exerting its market power over this nascent business. That is why we believe this merger should be blocked. If it is not, you will see less competition and choice in distribution, stifled innovation, and higher prices. Already the music industry has gone through breathtaking consolidation as six major record labels have become four. Already innovative online music companies are challenged to enter the U.S. market. For example, the online streaming service Deezer, which is similar to Spotify, it has enjoyed success in 200 territories around the world, but it has not been able to enter the U.S. market because of licensing.

EMI Music has gone against this trend. They were the first label to sell a digital download. They were the first label to remove digital rights management from their MP3s and iTunes, allowing consumers to listen to their music on any device. And they are the only label that actively works as a liaison between application developers and artists through their Open EMI Project.
If this merger is allowed, consumers and artists will be the losers. Removing a maverick competitor like EMI from the market will ensure that the remaining three players obtain more control over the future of online music. I ask that the members of the Subcommittee take a hard look at this merger and its impact on consumers and artists.

Thank you.

[The prepared statement of Ms. Sohn appears as a submission for the record.]

Chairman KOHL. Thank you, Ms. Sohn.

Mr. Grainge, Universal has argued—your company—that we should not worry about its purchase of EMI even though this will result in only three major record companies that will remain because the record companies have little power over price. You contend that pricing power is in the hands of online companies like Apple iTunes or large chains like WalMart and that you cannot raise prices because you compete with free pirated music. You also argue that EMI is not competitively significant because it has few top artists under contract.

So then please explain to us, why did Universal pay $1.9 billion for EMI?

Mr. GRAINGE. Senator, this is an incredibly changing landscape. The competition within the industry is really quite extreme and vibrant, and we are absolutely committed to giving our music—giving the artists as many opportunities to get their music to as many consumers and fans as we can.

I must say that from my experience and where I sit, we would be insane not to license, develop, make our music available through as many platforms, through as many retailers as possible. Through technology, the consumer is voting and is telling all of us what they want, and we have to make it available.

Chairman KOHL. Mr. Bronfman, why do you think Universal wants to buy EMI?

Mr. BRONFMAN. Well, I think the three words from the movie "All the President's Men" is useful: "Follow the money." Universal is spending not only $1.9 billion to buy EMI, but it is taking even further risk because it has agreed to pay that purchase price, or essentially all of it, whether or not it achieves regulatory approval. If it does not achieve regulatory approval, the business goes back to Citi, Citi has to sell it in a distressed sale to someone else and remit whatever price they get to Universal. So Universal, if it does not buy EMI, is at risk for hundreds of millions of dollars. So, clearly, Universal wants it very, very badly. And the real reason is that it buys them a market-dominant position.

It is very interesting to listen to the three witnesses to my right talk about how the Internet has changed the industry, and it has. But no one should be fooled that access equals revenue. Access does not equal revenue. Ninety-two percent of all radio airplay in the United States is controlled by major music labels. Of all the songs on iTunes, 94 percent of those songs have been downloaded 100 times or less in the past year.

This is an industry that does not operate on the 80/20 rule. It is an industry that operates on the 5/95 rule. Five percent of our products represent 95 percent of our revenue. So access is one
thing, revenue is another, and controlling that 5 percent is very, very valuable indeed. And that is why they are paying the price they are.

Chairman KOHL. Mr. Bronfman, we understand that Warner Music attempted to purchase EMI. Is your opposition to the merger motivated by Warner's commercial interest or the interests of consumers? Isn't it true that your opposition to this deal is that it does not benefit Warner?

Mr. BRONFMAN. Well, I certainly do not sit here and portray myself as a saint, Senator. What I would say, though, is that Warner's interests here are, frankly, not much more relevant than Sprint's interests were in the AT&T/T-Mobile merger. The fact of the matter is that this merger creates a market-dominant position—a market-dominant position that could not have been achieved by Warner had Warner acquired EMI. And so the words from Mr. Mills and Ms. Sohn are real. Granting this merger grants to Universal sort of the sole right to determine what digital services live, what digital services die, what they pay, how much they pay, et cetera. And I do not believe that this Committee should allow a very clear and significant concentration to occur. And I hope that the Committee will continue to investigate this and will come to that conclusion.

Chairman KOHL. Mr. Grainge, if this merger is approved, there will be only three major record companies, as we know—Universal, Sony, and Warner. It is a basic principle of antitrust analysis that reducing the number of competitors from four to three carries substantial risk of higher prices to consumers by making parallel pricing easier and eliminating the possibility of one maverick company engaging in things like price cutting. We saw this last year as we reviewed the AT&T/T-Mobile merger that, as you know, was ultimately blocked.

So why should this merger be viewed in any substantially different way?

Mr. GRAINGE. Senator, the thought that we would constrict our artists whom we have invested in and constrict the investment that we make in EMI to dissolve the market is—would be commercial suicide. And I would also have every single artist I have ever signed and every single artist I am ever going to sign in a line outside my door saying, “Get me out of here.”

We have a duty, we have a responsibility—I sit with artists—to sell and to bring their music to their audience and to their fans and to help them market it. Some of the descriptions are not the real operating world. We are here to invest in EMI to create more music, to create more options, to create more opportunities, and to create more platforms so that the music can be discovered and sold to legitimate fans.

Chairman KOHL. Ms. Sohn, what is your view? Does this merger carry the same risks for competition and consumers as any four-to-three merger?

Ms. SOHN. Absolutely. I think the parallels with the AT&T/T-Mobile merger are really spot on. If this merger were to go through, the top three labels would have 90 percent of the market, the top two would have 70 percent of the market, and you would have this one super major label that would have the ability to pick winners
and losers when it comes to digital distribution services. And these services lower prices for consumers, they provide more choice. So if Universal—if this new entity had the ability to basically decide who lives and who dies among digital music services, that is going to raise prices for consumers, and that is not good.

Chairman KOHL. Thank you.

Mr. Lee.

Senator LEE. Thank you, Mr. Chairman.

Mr. Azoff, you have achieved a great deal of success and wielded a lot of influence within the music industry. If I am not mistaken, Billboard ranked you first out of a list of 50 of the most influential people in the music industry in 2012. So given your background and your experience, I was curious to know what you would say in response to the question—well, let me just back up a little bit.

Critics of this merger have suggested—and we have heard some of this today—that the majors continue to have near-complete control over the music industry, especially when it comes to emerging digital distribution models. Do you believe this? Do you concur with that assessment? And if so, what is your reasoning?

Mr. AZOFF. First of all, you know, any position that I have in the industry always flows because I represent artists and they trust me. I have been predominantly a manager my entire career, and that is the core business I run at Live Nation every day. So when I speak, it is not just me saying these are my views. This is kind of a view I take from having talked to several artists, and, you know, labels traditionally have been the last guys to get it. You know, they kind of acquire more blocking rights than rights. There has been amongst the executives—and I was one at Universal in the 1980s—fear to change. I believe that we are at a transformational, wonderful point where, through all the criticism and bad that the Internet has brought for creative people in the music business, you know, the time is here and now that they can do it themselves.

You know, people that we represent like Jason Aldean on Broken Bow Records, currently Calvin Harris on Ultra Records, you know, I do not know why they are not on these charts, because they have exploded. A band from England called One Direction, you know, the music basically came off of Sirius/XM Radio. It is a Sony act. But, you know, these are exciting times where acts are happening quicker, careers are being made quicker that are translating——

Senator LEE. Is that tending to diminish the influence of the majors?

Mr. AZOFF. Yes. My point exactly.

Senator LEE. So with this particular merger, do you have an ongoing concern that—creating an even bigger major out of the biggest major that currently exists, aren’t you concerned that might cause some problems?

Mr. AZOFF. No. I actually think that it fosters artists to consider the independent sector or do it themselves even more. So from the artists’ point of view that I talk to, the less majors there are, the more options there are. And, in fact, for those—and there are artists that require incredible investment that do want the major label experience—the fact that there will now be a vibrant Capitol Records, which Universal has committed to staff, it is actually, you
know, it is the best of both worlds to me because you have now got more room for the independents, but you also have a more vibrant Capitol Records for those artists that do choose to want to be in that sector.

Senator Lee. So the impact on independent labels and unsigned artists would not necessarily be a negative one, in your opinion?

Mr. Azoff. It certainly might be a negative when I—you know, most of the artists that I speak to consider it a positive.

Senator Lee. OK. Ms. Sohn, I wanted to ask you a question. In your written testimony, you state that EMI is not a failing firm under antitrust analysis. Now, to my knowledge, neither of parties has suggested that EMI is a failing firm, but they have alleged that the merger might well result in what I think they describe as just a more efficient allocation of EMI's resources.

Do you believe that this proposed merger could or would result in a more efficient use of EMI's resources?

Ms. Sohn. I think what this merger would do is eliminate a maverick competitor, and that is not good for consumers, that is not good for the market. As I said before, they were the first label to take digital rights management off of their iTunes. They were the first to license to any music service that they did not own. They were the first to do a digital download. They did a David Bowie song in 1996.

So the fact of the matter is that EMI continues to push and push and push this industry to embrace digital technologies that they really have had trouble embracing. It kind of makes me laugh to hear some of the folks to my right now say how wonderful digital technologies are and these digital music services where I really think it actually scares the living daylights out of them because these services have the potential to eliminate the middle man. And they lower costs for consumers, and when you lower costs for consumers, you also lower your profit margin.

Senator Lee. I cannot imagine there is any player in this market that is not scared by the digital revolution in some way or another. That part is understandable. You are not suggesting that the fact that there is this fear of the uncertainty associated with the technology itself is indicative of a desire to create anticompetitive effects?

Ms. Sohn. No, but I am saying it provides an incentive to try to control the technology, to try to take a piece, as Universal has often done, try to take a piece of these services, charge excessive licensing rates, deny licensing. I mean, that has really been the history of Universal, is litigation, excessive licensing fees, denying licensing fees, and taking a piece of these services.

Senator Lee. So an increased opportunity and an increased incentive.

Mr. Grainge, do you want to respond to that? And while you are at it, do you want to also respond to a claim that was made a few minutes ago by Mr. Bronfman about the terms of the deal, the $1.9 billion being paid basically risk-free to the current owner of EMI?

Mr. Grainge. I can only continue to repeat what I have said, that it would be creatively insane for us not to work with as many digital services as possible. I have heard AT&T mentioned here a couple of times. We have no direct relationship, billing relationship,
with the consumer. The analogy just does not work. Our relationship, everything that we do, is to create business. I keep using this word “duty.” We have a duty to the people that we sign, whether or not they were signed in 1970 or whether or not they are signed tomorrow afternoon. They come to us to market, to sell, to create, to work with them on their music on a global basis, and that is what we do.

I think in terms of some of the other comments—we negotiate. Negotiation in a free market is the way a free market is constructed, and everybody who sits with me on this panel today who is in a negotiating position where you are making agreements will, I hope, agree with me. And we are very proud of what we do. I have spent my entire life, my entire career protecting artists and trying to create business and trying to create opportunity. And that is what I am going to spend, hopefully, the next 33 years doing as well.

Senator Lee. Thank you. I see my time has expired.

Chairman Kohl. Thank you, Mr. Lee.

Senator Franken.

Senator Franken. Thank you, Mr. Chairman.

Mr. Grainge, first I want to thank you and your staff for getting the information I requested yesterday. As I mentioned during our meeting, I was very concerned when I heard that major record labels like yours and Warner's are requiring digital platforms to turn over a piece of their equity as a condition of licensing your music library.

Let me quote your predecessor from 2008, Doug Morris. He said, “No one is going to build a business off our backs, if I can help it, without us being a part of it.”

He went on to say, “If one of these digital startups becomes a big enterprise and it is off our product, it seems to me that we should own part of it.”

Now, I understand this does not happen in every digital deal, but I worry that if your market share—and you said you negotiate, and market share counts in a negotiation. That is what you do. You negotiate. That if your market share swells to approximately 40 percent, you will have every incentive to demand more equity, a larger cut of ad revenues, of upfront payments, and other onerous terms from online startups as a condition of turning over your content.

Can you explain to me why this is not the case?

Mr. Grainge. Well, firstly, in terms of what my predecessor said, who is a great guy, I disagree with that.

Senator Franken. OK.

Mr. Grainge. It is in our complete interest to create as many opportunities for the music that we create so that consumers can buy it. In terms of our deals, we have well over 100 deals in the United States. They probably run into hundreds and hundreds of deals throughout the rest of the world. We are completely technologically agnostic. However consumers want to buy their music, whether or not it is on a phone or whether or not it is through a stream with a subscription model or ad-based, we love it.

Senator Franken. OK. Well, let me go to Ms. Sohn on that, because there is no doubt that the music industry has been turned upside down several years with the explosion of digital platforms,
and that is the subject I am talking about right now. And Mr. Grainge has repeated this over and over again. He would be insane not to let every platform that comes to him play his music.

Yet I understand from your testimony that Deezer, a music-streaming service that expects to be in 200 countries by the end of this month, has not been able to work out a deal with Universal that will allow it to launch in the U.S. This seems at odds with what Mr. Grainge is saying, and it seems to add credence to the idea that Universal will exploit its market position to the detriment of startup companies.

Can you explain what happened in the Deezer case and whether we should be skeptical of Mr. Grainge’s contention that they are doing everything possible to cut licensing deals with digital platforms?

Ms. Sohn. Thanks. So the Deezer situation is actually worse than you portray it because Universal sued Deezer in France because it did not like the fact that it was providing five free songs in its so-called freemium tier, so that is the tier that has ads on it. And it is interesting in France there are very, very detailed regulations that regulate the music industry and regulate these digital music services. So Universal sued Deezer under these regulations, and the French court not only sided with Deezer, but it said that Universal’s behavior was “an abuse of a dominant position.”

So, again, this is a pattern of lawsuits. Universal sued the video site Veoh, which won in court, was found to be legal in court. It was the first to sue the music-streaming service Grooveshark. It did not license to Beyond Oblivion, a Fox service that never launched. It raised its fees on eMusic so high that it was forced to raise prices, and it has equity stakes in MōG, Spotify, and Vevo.

So that is the modus operandi. I do not consider that embracing digital music services. I consider that trying desperately to either get a piece of it or stop them.

Senator Franken. OK. Mr. Grainge, I want to give you an opportunity to respond to that, but since Mr. Mills has to fly away, I want to make sure that I get a chance to talk to him in this round.

Mr. Mills, I had a meeting with Universal yesterday, and, you know, every individual I liked. I think all of you probably are friends, and for good reason. You are all nice people.

[Laughter.]

Senator Franken. And we had a great time.

Anyway, but someone in that meeting said that a single artist could make or break a digital platform, because today’s consumer of digital platforms expect every song in the universe to be on that digital platform, and if one artist is not on that, they will go on social media and tell their friends, “Do not go on this because not every artist is on it.”

Now, I understand your artist, Adele, has chosen to keep her songs off of Spotify. Is that true?

Mr. Mills. Some of them, yes. Most of the most recent album.

Senator Franken. OK. Now, do you think that has impacted Spotify’s ability to succeed? And what would you say about this argument that if you had one artist with one song missing, it will bring down a digital platform? That does not seem to hold for me.
Mr. MILLS. No, I think that is an unsustainably extreme position. Having said that, though, we believe with independents that services that provide the widest possible range of music will do best. If you look at iTunes and Spotify, for example, they both do that.

Adele’s decision to keep most of her music off Spotify has been her own decision, not ours. We are great supporters of Spotify. I think that clearly any digital platform needs big songs. It needs the “must-have” repertoire, which is where Universal’s power and dominance and control is of considerable concern to us because no service can exist without Universal. And I think as the lady to my left mentioned, most tellingly, when Universal came on to eMusic, eMusic was a platform dedicated completely to independent labels and independent artists. They realized over time that they could not sustain their business with just independents. They gradually brought on the majors. Universal was the last one to be brought on, and when they brought them on, they changed their terms of trading completely. The front-line prices went up, back-line prices went down, and the service became a completely different animal, such to the extent that we decided we didn’t want to work with it anymore. So Universal’s dominance in that particular instance changed the nature of that service.

Senator FRANKEN. Well, thank you. My time is up. I hope we can get to a second round. Thank you, Mr. Chairman.

Chairman KOHL. Thank you, Senator Franken.

Senator BLUMENTHAL. Thank you, Mr. Chairman, and thank you for holding this hearing. And I would like to thank all the participants for being here today, and I hope that, just as you are friends of Al Franken now, you will be friends of all of us at the end of it. But thank you for being here.

You know, the American Antitrust Institute submitted an analysis, which no doubt you have read, showing that market share in the digital and physical music marketplace has been virtually constant over the last 6 years, and those shares have stayed constant regardless of these major technological revolutions in recording and distribution costs. And all of the four major labels have retained their hold on 90 percent of the market.

In the ordinary antitrust analysis, that would bespeak lack of significant competition. In the ordinary antitrust analysis, reducing competitors, assuming there is competition from four to three, would sound major alarm bells. It might even be regarded as a five-alarm fire. And, in fact, Ms. Sohn draws the analogy to the AT&T/T-Mobile situation where, exactly as here, the number of competitors went from four to three.

Is there something about this industry that makes it so unique that we should not apply ordinary antitrust analysis, Mr. Grainge.

Mr. GRAINDE. I think that market share in this industry is far less relevant than maybe in any other industry. As I said, telephone analogies and consumer relationships in my opinion are not relevant. We do not have a direct relationship with the consumer. And I think that the artists make the market. I think that you are as good as your market, depending on what choices you have made and what artists you have signed and how well you have delivered
them to the market and how well you have created a demand for them.

We have heard about Adele and, Mr. Mills, I wish we had Adele, but we did not. And Adele has had probably one of the biggest-selling albums for maybe the last 10 years.

Senator BLUMENTHAL. And I understand that point, essentially—Mr. Azoff makes it very well—that artists have the kind of access to their fans that perhaps makes it somewhat distinctive. But should we simply disregard the normal antitrust analysis here? Let me pose that question to anyone on your side of the table who would like to—or any of the witnesses. Mr. Mills.

Mr. MILLS. I would like to answer it, if I may. I think any ordinary antitrust analysis is even more crucial in this because we are all monopolies. I have a monopoly on Adele’s music. Mr. Grainge has a monopoly on Lady Gaga’s music. The whole nature of copyright is that you can only get one artist from any source. It is not like airline tickets which are interchangeable, as I said in my address. We are all little monopolies. And I think that makes antitrust far more crucial in our IP-based industry than in any other.

Senator BLUMENTHAL. Ms. Sohn.

Ms. SOHN. So antitrust law addresses market power, right? It does not address market share so much as the amount of power you can impose on a market. And as we said before, because this new entity would control 42 percent of the market, it could impose its will on any digital music service. That is what is really, really important. And I think you cannot also forget the fact that for corporations copyrights last 90 years. So that is another monopoly on top of a monopoly. So you are not only in control of the—each label not only has its own artists, but those copyrights are also a monopoly that lasts 90 years.

Mr. AZOFF. I think that we are a very unique industry, and the point where, you know, I guess you could say that Apple was built on the back of recorded music a bit, you know, the company was struggling. Sony, the Sony Walkman certainly saved Sony; the creative works of artists helped that. So I do not think you can apply—you know, we are a quirky, crazy industry that relay, you know, its people’s creative works. What I love about what is going on is for the first time in my 43 years in the business, artists have real power. So I just do not think you can apply market share standards to any of it for that reason.

Mr. FAXON. I would like to add that I think that what I have been hearing from those who are opposed is a view of a market that is 10 years old. We are in a very different place. In 2002, the major record companies tried to come together to control distribution in the online world. They failed dismally. It was a clarion call to an industry that thought that it could control the way that music could reach consumers. It could not. The consumers broke through. They found the music wherever they could find it. They brought it, and that is why no music company—no music company—can stand away from licensing rights into the marketplace. It will not have a business.

And Mr. Azoff’s customers and Mr. Mills’ artists will never sign on to those labels because they will not be in the market. They will have denied access, and that means that they are out of business.
And it is a fundamental shift in the way in which this market has worked.

Senator BLUMENTHAL. My concern is that your argument or justification for the merger seems to depend on asserting that antitrust principles and precedent such as we would apply to almost any other industry simply should not be applied here because it is a unique or quirky industry that is fast-changing and where fans have certain powers, which I think is a heavy lift.

Mr. FAXON. Senator, I would not say that. I would not say that antitrust principles should not be applied. They absolutely should be applied. The question in antitrust is not, as Ms. Sohn said, about what your market share is. It is about whether or not you can exercise market power. And the balance of power—the other services create your access. They have the power to keep you from having access. There is an equalizing force here, and that force is set really for the first time in our experience by the consumer because the consumer decides where they are going to actually find their music.

And so the power is sitting in the consumer's hands, and I think that that changes the business structure, but it does not change the analysis. It is about where the market power is. And I think if you look at Ms. Sohn's discussion, she very clearly talks about the empowering of artists and the empowering of consumers. But nowhere does she bring that back to an analysis of antitrust. If they are empowered, why is it that the record company somehow is a blockage? They control where the market goes, and we have to deliver against it. And every time this industry has fought that, it has lost. And look at how much it has lost.

Senator BLUMENTHAL. My time has expired. Mr. Bronfman I think he wants to add something, so with the Chairman's permission——

Mr. MILLS. Mr. Chairman, sorry. May I be excused? I appreciate that. Thank you very much.

Chairman KOHL. Thank you, Mr. Mills. We appreciate your being here.

Mr. BRONFMAN. Senator Kohl, thank you for giving me some time to respond.

First of all, I was interested to hear Roger say that the answers that we have given are 10 years old. I would say at least we have given some answers, because I have not heard anyone on my right actually answer a question from the Senators that they have asked.

What I would say is when we talk about market power, let us just ask a very simple question. If you are a digital startup, who do you go to to get a license? With all respect to Mr. Azoff, who may be the most powerful man in the music industry, they do not go to Mr. Azoff. They do not go to Live Nation. They do not go to Front Line. They go to Universal, they go to EMI, they go to Warner, and they go to Sony. And if Universal and EMI together have half of the hits and 40 percent of the market, there is only one place any digital startup must go. Everyone else becomes irrelevant. They go to Universal.
Lucian, whom I have great respect for and great friendship for, said he hopes we would agree that we all negotiate. Well, licensing is about negotiation, but Warner historically has always sought its market share in its licensing deals so that its revenues would represent equal to its market share. Universal has historically sought greater than its market share in its negotiations with the licensing deals. That is a negotiation. It is a free market. But let us not pretend that all licensing is created equal. Licensing is not created equal.

In addition, Universal talks about how many licenses they do. Well, let me tell you, at least 50 of those licenses are exclusionary licenses. They are licenses where only Universal Music is licensed and other music companies will be invited in some time later.

So, again, there may be hundreds of deals, but they are not all created equal. They are not all created in the same terms and conditions. And so the issue is not whether or not Universal will or will not license. Sometimes they will, sometimes they will not. But it is also about the terms on which a market-dominant power can license and will license.

Chairman KOHL. Thank you.

Senator BLUMENTHAL. Thank you, Mr. Chairman.

Chairman KOHL. Mr. Grainge, you argue that record companies are not so important in this new digital age. An artist does not even need a record company to distribute music on the Internet. Nevertheless, of the top-selling songs in 2011, the four major record companies distributed 96.5 percent of them, and the four major record companies controlled or distributed 100 percent of the 100 titles making up the Billboard Hot 100 chart for 2011.

Don’t these stats demonstrate as clearly as can be that the continued importance of the four major record companies is intact?

Mr. GRAINGE. Senator, I am not aware of any of those stats. All I can continue to say is we try and create as much quality music and music that consumers want to buy, and that is what we do and that is what we are dedicated to.

Chairman KOHL. Mr. Grainge, to follow up, the Wall Street Journal reported this week that, speaking at a conference in March of 2011, the chief financial officer of your corporate parent, Vivendi, Philippe Capron said, and I quote: “Given our market share in many territories, North America, and most European countries, we could not completely buy the recording businesses of either EMI or Warner.”

Do you know why a senior executive in your corporate parent held a view which is apparently contrary to yours just a year ago?

Mr. GRAINGE. Senator, I understand—I have heard the quote, and I understand why you ask me about it. I cannot speak for him. I was not there. He is a financial person at our corporate parent, and I disagree with him.

Chairman KOHL. Mr. Bronfman said a few minutes ago—and, incidentally, he came to visit us the other day, and he said you are among the smartest and toughest, most effective executives around, so it does not detract from his admiration for you, nor ours. To reiterate what he said just a minute ago, you do not seem to answer questions very completely or very accurately.

[Laughter.]
Chairman KOHL. Which is part of your smartness and toughness. Would you agree with that, Mr. Bronfman?

Mr. BRONFMAN. I would agree with almost anything you would say, Senator.

[Laughter.]

Chairman KOHL. You are pretty smart yourself.

Mr. Grainge, we understand that you argue that we should not worry about this merger because illegal music downloading makes it practically impossible for record labels to raise the price of music when consumers can just go to illegal download sites they can go to and get music for free. However, in April of 2009, Apple iTunes, the Nation’s leading online music download service, raised its prices by 30 percent from 99 cents to $1.29 per single for most new releases.

Despite this 30-percent increase, consumers continue to pay for the music. The number of singles downloaded actually increased from about 5 million per day in April of 2009 to over 9 million a day in January of 2010, less than a year later. All of these consumers could have obtained this music for free on illegal sites. Doesn't the experience with the Apple iTunes price increase in 2009 show that consumers will accept price increases for music?

Mr. GRAINGE. Senator, the original launch price was exactly what it was supposed to be—a launch price. And it was something which Apple and Steve Jobs, who I got to know over a period of time, basically pulled out of the air.

Over that period of time since the launch of iTunes, there was one price increase in a 9-year period. As part of that deal, Apple lifted the restriction of the digital rights management, which meant that the people who bought the downloads could share them and move them around their own devices. We increased the quality in the bits of the sound quality, and they also at the time went to variable pricing, and there were tens of thousands of tracks which also reduced in price.

Chairman KOHL. Ms. Sohn, what is your view? Why would consumers pay 30-percent higher prices for singles on iTunes when they could just download the music from illegal sites for free?

Ms. SOHN. Well, it is because there is absolutely no evidence and the proponents of the merger have not presented any evidence that piracy exerts any downward pressure on prices whatsoever. And the fact of the matter is last year alone consumers spent over $2.5 billion on digital music, so that shows a real desire there to access music legally. So if piracy was a factor, why didn’t they just go get it for free? I mean, if consumers are willing to pay an average of $10.40 for a digital album, why would they suddenly resort to piracy if that price went up to $11.

Mr. Bronfman's company provided some numbers to the FCC showing that pirates are actually a really very, very small percentage of music buyers and that, if anything, what Mr. Grainge has to worry about are people that listen to the radio because they are the ones that really do not buy music.

So piracy has had absolutely no effect on prices whatsoever, and nothing I saw in any of the testimony of the proponents showed otherwise. It is just hand waving.
Chairman KOHL. How do you respond to that, Mr. Grainge? Then Mr. Faxon. Mr. Faxon, you first?

Mr. FAXON. Yes, I just think that we have to understand the setting in which this industry is. In the world of music, over the last decade plus, more than half of the sales of the industry have disappeared. And in that same period, a vast amount of music has been consumed through pirate sites and in illegal ways—some quasi-illegal, some quite illegal. So there has to be an inference that any logical person would take that there is a relationship between the pirate world and the legitimate world, and that consumer demand, consumers' desire for music, has not declined. Their purchasing behavior has.

And so price has something to do with purchasing behavior. It is our role, our job, to try and see whether we can find a way to entice consumers back into the marketplace and pay so that our artists get paid and that the entire cost of the industry gets—so there is a constraint, and some people clearly will go into the market and buy in only a legitimate way. But half the demand has gone—half the actual purchasing demand has disappeared, whereas consumption has gone up. So I think it is a little disingenuous—I would say it does not have any impact.

Chairman KOHL. Ms. Sohn, do you——

Ms. SOHN. This one really deserves a response because the reason the revenue went down was because they were selling nothing but CDs, they were found guilty of price fixing by 43 States and the Federal Government, and they stopped selling singles. That is why—so your revenue went down because once you were found accused of—found guilty of price fixing your CD prices and then started selling singles again, people bought the singles. They did not want to buy ten songs they did not want for two songs they did. That is why revenues have gone down. But as everybody admits now, your digital sales are skyrocketing. It is just that—and both albums and singles. So that is why your revenues were cut, not just because of piracy.

Mr. FAXON. I think one of the things that would be useful is to ask for corrections of the record after we do this because I think Ms. Sohn has misstated the history, and rather than take your time with arguing over that, it would be good for her to relook at her testimony and come back with a more accurate——

Ms. SOHN. Look at the report filed by Public Knowledge and Consumer Federation of America. It is all in there.

Chairman KOHL. All right. Before we turn to Senator Lee, Mr. Azoff.

Mr. AZOFF. Let me just tell you a quick story of how piracy impacts an artist. An artist I started with at the University of Illinois 40-some years ago retired about 20 years ago. His earnings from his artist royalties and his writing and publishing were around $400,000 a year. Traditionally in the industry, that would go up every year. He came to see me recently. His earnings from this very active catalogue have dwindled to $68,000 a year. The only place you can point to is piracy, because the catalogue sold steadily, steadily, steadily, and the minute free music on the Internet came, it just fell off a cliff.

Chairman KOHL. All right. Mr. Bronfman.
Mr. Bronfman. I would not sit here as someone who has run a record company for the last 17 years and say that piracy has had no effect. I think it has had some effect. But I would also agree that another large effect is that when iTunes came along, we stopped selling albums and started selling singles. And so you had people interested in buying, but they were finally able to buy the song or two that they liked, not the 10 or 12 that we had forced them to buy in the album world.

The reason I make that point is if a new startup came with a business model such as that that threatened the industry, which in some ways created risk to the business model, and you had half of the music controlled by one company, why would that company license a business that threatened the status quo, that threatened either its dominance or its business model?

Now, the truth is that Apple has been a great thing for the U.S. economy, but it is not clear that, given what we know today, that a dominant company would have allowed an iTunes startup to occur, or the next one, because 6 years ago there was no Facebook, 8 years ago there was no Google, 12 years ago there was no iTunes. We do not know what is coming next. And when you give one company the power to choose whether or not those businesses can even begin, I think it trips the line of reasonableness.

Chairman Kohl. Senator Lee.

Senator Lee. Thank you very much, Mr. Chairman.

Before we proceed any further, I just wanted to point out that under almost any definition of the relevant markets that we could think of, I think most of us in the room would have to agree that this merger, if it proceeded, would result in a pretty significant degree of concentration. But we also have to remember that this is not the end of the analysis. You know, as Section 5.3 of the merger guidelines make clear, on page 19 of the 2010 edition, this is not the end of the analysis, and the merger can still proceed where other competitive factors counteract the potentially harmful effects of increased concentration. And so that is a lot of what we have to look at here. It is not a simple matter of just looking to whether or not it is going to result in increased concentration. I think that is pretty certain that it will.

So with that in mind, Mr. Faxon, I wanted to ask you a little bit about EMI. EMI has passed through a number of hands in recent years. You know, for a while it was owned by the private equity firm Terra Firma, and then it was owned by a banking firm, Citigroup—neither of them giants in the music recording industry. Giants within their own realms, of course, but their specialty, their expertise, is not in music.

So while the job that Citigroup has done, for example, is admirable, there are some observers who perhaps are excited to see EMI owned by a member of the music industry.

So my questions for you are: First, what do you think music industry ownership for EMI might do for EMI? And then, secondly, how do you think revitalization of Capitol Records might affect the market?

Mr. Faxon. I think obviously Citibank is not a natural owner of a music business. It has enough troubles on its own to consume its time.
What a music business needs, as Mr. Azoff said, is it needs stability because, remember, our product is not a disc. It is the output of human beings who need to be motivated and need to feel safe and protected as they pursue a very dangerous career. Think about yourself the first time you ever got up on stage and had to give a speech.

Senator LEE. And I did not even have to sing.

[Laughter.]

Mr. FAXON. Right, and you did not have to sing. So what we lose in these events, in these discussions, is that we are talking about human beings and the lives of human beings. Our artists depend on us to be able to be with them and help them achieve the success that they dream about. That is what our job is. And with that comes a responsibility of being there for them as they develop.

So one of the problems that has existed at EMI is that sense of instability, the sense that what is going to happen to that business going forward. So coming to a home where there is a stable environment, where the team that helps the artist develop their music and helps them find fans to love that music, are going to be with them for a while, is a huge—it is a massive improvement. And, you know, saying that is music to my ears to hear Lucian talk about trying to keep Capitol Records and build it back into the important label that it has been in the past, that is a fantastic thing, and the people at EMI are grateful for that.

But consumers should be grateful for it because it is—it will be a creative engine. It will be a place—an engine room, and it will be a place where more music will be provided into the market. And we are in the innovation business. You know, think about it. Our product is new, creative works on a constant flow basis. That is what we are trying to bring in. If consumers do not like it, we do not do well. If consumers do like it, we do much better. It is as simple as that. And so it is a good thing to have a home that wants to create a stable base for our business.

Senator LEE. So you are saying it will result in the creation of more creative material, whether the consumers like that or not.

Mr. FAXON. I believe so, yes.

Senator LEE. OK. Mr. Bronfman, let us turn to you for a minute. In 2009, EMI became a pioneer of sorts when it became, I think, the first major label to license its music without digital rights management, and that led, I think, to an industry-wide adoption of DRM-free music buying and selling. EMI was able to initiate a fairly significant change in the industry, even though it had only 10 percent of the market at the time.

So my question for you is: In a post-merger market, in a market following a merger between Universal and EMI, do you think Warner with, say, 20 percent of the market or Sony with 30 percent could perhaps be able to initiate a successful, sequential contracting process?

Mr. BRONFMAN. Senator, I would like to answer that question, and if you do not mind, I would like to comment on the previous answer as well.

Senator LEE. Sure.

Mr. BRONFMAN. I think that the fact that EMI in the instance you mention or Warner in other instances or Sony or Universal in
other instances speaks to the importance of this competitive balance that currently exists. As the market becomes more concentrated, as one company essentially controls half of the hits and 40 percent of the overall market, the ability for a third company to influence the outcome becomes smaller and smaller.

I cannot say for sure that Warner could or could not, but, clearly, it will be less able to tomorrow if this merger is approved than it would be able to today.

Senator Lee. Even with its own particular market share being unchanged from what it was.

Mr. Bronfman. Yes, because essentially at 50 percent of the hits, Universal can do what it wants, period. Universal can say no to anything. And so, yes, sure, Warner can say yes to something, but at 50 percent of the hits, Universal can say no to anything. And I would just——

Senator Lee. Would you really phrase it as 50 percent of the hits? I mean, is that the right way to look at it?

Mr. Bronfman. Well, it was last year. Some years it is even greater.

Senator Lee. Right. But you are not necessarily saying that represents 50-percent market share, but——

Mr. Bronfman. No, sir. I am saying the overall market share is 40-plus percent. A share of the hits is 50 percent.

Senator Lee. We do not want to punish them for having a lot of hits, though.

Mr. Bronfman. I complimented Mr. Grainge to Senator Kohl. I compliment the work that he has done. And I think if Universal were able to get to 42-percent market share through its own sweat and hard work, more power to them.

Senator Lee. Maybe they should be required to send some really bad artists—I can help them find some.

Mr. Bronfman. By the way, we both manage to find some really bad artists from time to time. [Laughter.]

Mr. Grainge. We agree.

Mr. Azoff. I do not manage any bad artists. [Laughter.]

Mr. Bronfman. No. You just wait for all the others to fail, and then you pick them up.

So the notion here is that if a company can grow to whatever size on its own and does not abuse that market position, the Government should have no role in that whatsoever. But when a company is seeking to acquire a market-dominant position, Government does have a role. And in my view, Universal is trying to seek a market-dominant position, and I think this Committee should look at that and I hope would help the FTC to look at it and ultimately use its influence to see that this merger is not consummated.

And just one quick point to Roger's comment about finding a music home. I think the issue is less about ownership than it is about leadership. When my partners and I acquired Warner Music, Warner had traditionally been owned by Time Warner, which has many entertainment assets, media assets, one of the great media companies in the world. But music within that environment was an orphan. It was small within Time Warner. It was not that impor-
tant. And the music division was very dispirited. Even under a private equity ownership that then came along with me, Warner succeeded much beyond what people thought originally, and we created a very successful company out of that.

So I think the issue is not whether or not a music company needs to be in a music home. A music company needs to be with leadership that understands what it needs. And I think as Roger described the needs of a music company, I would agree with him. It needs stability, it needs sensitivity, it needs leadership. But that can come from many places. It does not necessarily only come from a larger music company.

Senator LEE. And if you could point to any one metric that troubles you most, is it market share or is it the share of hits in recent years?

Mr. BRONFMAN. It is market power, Senator. It is the power to determine the outcome of so many different things.

You know, in the digital download world, hits are critical, and so Universal has a disproportionate weight and market power in the digital download world. But, interestingly, as the subscription world—Spotify—grows, what are we discovering. We are discovering that catalogue is actually much more important in that world than it is in the digital download world. EMI happens to control, thanks to the work of people for the last five decades, ten decades, one of the greatest catalogues ever amassed in human history. When you put that catalogue together with Universal’s catalogue, you have enormous market power in the streaming world.

Senator LEE. But, of course, it is not about market power. It is not only about market power. You know, the question we have to ask is whether that market power manifests itself—whether it is wielded in such a way that it results in harm to consumer welfare.

Mr. BRONFMAN. Senator, with all respect, that may be the question that you ask. My question is: If you grant a company market dominance by granting them the kind of market power that this transaction gives to them and then simply hope that they will wield that power responsibly, I do not think that personally is the right approach to antitrust policy.

Senator LEE. OK. My time has significantly expired.

Mr. AZOFF. Can I add one comment to what Mr. Bronfman said? Unless I am mistaken, Universal licensed Spotify first and Warner was the last one in, number one.

Number two, when you talk about EMI’s catalogue, I also believe that, you know, what is the real worth of the biggest thing about the EMI catalogue is the Beatles. They were not on iTunes until recently. If you believe the printed reports, I believe the Beatles hold, you know, a big say if not a final say on anything that goes on digitally with that catalogue. I do not think that the digital rights to the Beatles flow in this deal as simply as everyone thinks.

Thank you.

Senator LEE. Thank you.

Chairman KOHL. Senator Franken.

Senator FRANKEN. Well, thank you, Mr. Chairman. A few things. First of all, I do not think, in all due respect to Mr. Azoff, I do not think that Universal was the first on Spotify. Am I right?

Ms. SOHN. It was the third.
Senator Franken. They were the third.
Ms. Sohn. It was the third after EMI and Sony.
Senator Franken. OK.
Mr. Grainge. We were in before Warner.
Mr. Bronfman. Which makes my point, Senator. That makes my point, which is that in this competitive, dynamic world where you have four people supporting innovation all with different perspectives, innovation is going to survive and thrive much more than in a world where one person can determine the outcome.
Senator Franken. OK. I just wanted to make that clear because that was my understanding, and I just did not want that to stand.
In terms of Senator Lee’s point on Citigroup and EMI, you do not think of Citigroup as nurturing, finding and nurturing artists, but Vivendi, I might say, was a water company, then a transportation company, and then it went into construction and waste management, and I do not think it was a media company until the 1990s, if I am correct. And, also, when I was at “Saturday Night Live,” General Electric bought NBC, and we were run by Bob Wright, who we used to call “a toaster salesman.” But he was one of the great chairmen of NBC. He did an unbelievable job. So, you know, let us not——
Mr. Faxon. Senator, I will be sure to tell Vikram that you think he would make a great executive in a music business.
Senator Franken. Well, I do not know him. I know Bob Wright and he did a great job. I do not know what point I was making, but I think I made it.
[Laughter.]
Senator Franken. Mr. Grainge, I promised you a chance to respond to Ms. Sohn’s comment on Deezer, and I would also like you to respond to the quote I read in the Telegraph where you said, “If there was only iTunes providing digital music and they tripled my sales, I would be delighted.”
This seems to undercut what I am hearing from you today about your desire—you know, you wish nothing more than to expand the universe of digital licensing deals. Can you explain that seeming contradiction?
Mr. Grainge. I think that that quote was probably from 5, 6, or even 7 years ago.
Senator Franken. You have changed your mind on that?
Mr. Grainge. Well, it is probably the last time I spoke to the Telegraph.
Senator Franken. Yes, but they have been—have they been able to hear your phone calls or anything like that?
I do not know the British press. I am sorry.
[Laughter.]
Mr. Grainge. The contribution that Apple has made to the music industry over this last period has been incredibly powerful. We have since that time hundreds and hundreds and hundreds of deals worldwide, so in terms of the evidence of what we do and what our behavior is, I am actually very proud of, and we will continue to deliver our music to as many people in as many ways as we can in as many partnerships.
You have also got to remember that in this game you want to keep as many people focused and optimistic about selling music.
And it is really important that we continue to sell our music in every form, as well as CDs and as well as, you know, what we call “physical product.”

Senator FRANKEN. Could you respond on Deezer in terms of how that—that also seems to kind of contradict the record on Deezer.

Mr. GRAINGE. Yes, I am not aware of the Deezer specifics. I was aware that there was a problem in France. There are problems in our business every single day of the week. There is constant fire-fighting. There is so much disruption in the industry. There is so much disruption in the technology. And in some of the things that we are doing, we are making it up as we go along in the same way that the platforms are. And we are experimenting the whole time.

Again, I think to highlight——

Senator FRANKEN. I wish I had a job as exciting as yours.
That was a joke, too, everybody.

[Laughter.]

Senator FRANKEN. You see, it happens to us.

Go ahead. I am sorry.

Mr. GRAINGE. We have hundreds of deals. We manage some 80, 90 operating companies in markets throughout the world. And to pick out two or three or four problems when we have the amount of music with the amount of contracts with the amount of people that we work with I think is actually unfair.

Senator FRANKEN. OK, fair enough.

Ms. Sohn, according to the American Anti-trust Institute, it took spotify 2 years to work out licensing deals with the four majors in the U.S. and this after having had incredible success in Europe. Sony and EMI apparently were the first two, right? Is that——

Ms. SOHN. Yes.

Senator FRANKEN. OK. To step up to the plate, and it took several more months before Universal and Warner finally worked out an agreement. This also seems to refute Mr. Grainge’s point that Universal is a leader in cutting digital deals and he wants nothing more than to create these deals and create more digital platforms.

Do you agree that Universal appears to have dragged its feet in that licensing deal?

Ms. SOHN. Yes, absolutely. I mean, Spotify was very, very slow to come to the U.S. market. It is not yet profitable. In fact, it is quite unprofitable.

I want to actually give you two more examples. I know I gave a laundry list before, but I think, again, they continue to be—it is more than two or three examples, Mr. Grainge, I am sorry to say, that Universal is the third of the four major labels to license its catalogue to Google Music. And with Zune, you know, Microsoft Zune, it took a piece of every single Zune that was sold. So that is another example of either excessive licensing, litigation, or taking a piece of the music service. And that control is not insignificant. I do not know the amount of the control because that kind of stuff is all under nondisclosure agreements, but, you know, when you have that kind of market power, it is not insignificant.

Senator FRANKEN. Well, I really—I know my time has run out, but I would like Mr. Grainge to be able to respond to that. Is that OK, Mr. Chairman?

Chairman KOHL. Sure.
Senator Franken. Mr. Grainge.

Mr. Grainge. We are trying to talk about the future of music, how fans can get music. To get into a he-said/she-said—and I cannot speak, and neither do I think any of us can speak, for the companies for which we are actually being told that this is what they said or this is what we did or this is how we behaved or operated.

Senator Franken. I think that what it speaks to is your businesses, your companies' recent history regarding negotiations with digital platforms when what we are talking about here is your market power going to be so large that it disrupts that world. I think that is why we are discussing that, and I do not think it is just a he-said/she-said. I think it is relevant to our discussion.

Mr. Grainge. Senator, I completely stand by everything that I have said, that we license, we embrace as many digital platforms and as many business partners as we can. And the sheer thought that we would constrict these platforms, that we would constrict who we sell to and how we sell and why we sell—if we do not sell, we go out of business. Most of these companies—we are not talking about nascent, small organizations. Some of these are bigger than the entire music industry combined. My artists will leave, jobs will go, piracy will continue to be rampant, and it is just not feasible that we will do anything else other—we have a duty and responsibility to the people that we sign, and I have got a duty to the people that we invest in as well. We make that investment. We have to sell, we have to create, we have to discover. And I hope you understand I feel very, very strongly about that.

Mr. Faxon. Senator, I just wanted to add one additional thing. The discussion of the length of time of negotiation, we are talking about breaking new ground. The music industry is at the forefront of where technology is taking our marketplace. It is the pioneer. One has to walk that path very carefully. One has to understand all of the nuances and elements that go into those decisions.

Spotify is an interesting thing. It is a service that says: Here is all the music in the world, take your pick, and do not pay anything for it. And maybe—maybe—if you have these other mobile services and other things attached, we will get you across the border to pay for that.

Senator Franken. It has advertising.

Mr. Faxon. Yes, well, they have some advertising. If you have been on, you know. But the proposition was free leading to a pay tier. No one had ever done it. You did not know what the outcome was going to be. And you are setting a structure for a future. So you do that carefully.

But this industry has come forward and done those things. It has done things that for many people would be inconceivable 5 years, 10 years ago. So the fact that it takes 5 or 6 months or a year or whatever it takes to get there, the fact that we have demonstrated that we get there is something I think is the point to take away from this discussion.

Now, I would ask Edgar why he has not gone along with Google Music, why he has not done those things, because I think he has been more likely to be the last person in.

Senator Franken. Well, my time has expired. Mr. Chairman, I would turn it over to you and your judgment.
Chairman KOHL. Thank you, Senator Franken.

Senator Klobuchar, do you want to make a comment or two?

Senator KLOBUCHAR. Well, thank you very much, and I am sorry for leaving, but as Senator Franken knows, we have had floods in Duluth, we had the farm bill, but I also know that we are also the home of many great musicians, including Bob Dylan and Prince, as well as many other successful bands like the Jayhawks, the Replacements, and Soul Asylum, just to name a few. And so I thought I would quickly come back to ask a few questions here.

Now, I know some of this hearing has focused on market shares, competition, prices, and other economic dynamics, but I think it is also important to consider what the impact might be on music itself, especially given my State. I guess I can just ask all of you this. How do you see how the merger would affect music being available to the public, and whether it allows more bands to get in and out to the masses and more sounds, or whether it has the opposite effect or no effect at all?

Ms. SOHN. Well, I will start. Thanks for that question. So four to three means less choice, and not just less choice for consumers but less choice for artists as well. I think a great example here is Katy Perry, who was against the merger and now all of a sudden is for the merger. Funny how that happens. But she was rejected by Universal, and she went to EMI, and she loved EMI. So you take EMI away, that is just one less place that an artist can go to.

As far as consumers are concerned, our concern is that if you put so much power in one company with must-have music, that they will be able to dictate the terms and dictate the survival of every new digital music service out there. And that is not good for consumers either because those services lower prices for consumers, give them more choice, and are generally to their benefit.

Senator KLOBUCHAR. Thank you.

Mr. Bronfman.

Mr. BRONFMAN. Thank you, Senator. Just to say I do not know whether past is prologue or not, but in the three mergers that have occurred recently—well, two mergers and a restructuring that occurred in the music industry recently—the Universal/Polygram merger, the Sony/BMG merger, and the Warner restructuring—I was involved in two of those three, Universal/Polygram and the Warner restructuring. In all three of them, the artist roster post-merger or restructuring was reduced somewhere between 30 and 40 percent. So there were 30 to 40 percent fewer artists remaining on the artist roster at Universal once it acquired Polygram, about 30 to 40 percent fewer artists at Sony/BMG when they were through merging, and about 30 percent fewer artists at Warner when we were through restructuring.

So, again, I cannot speak to what is going to happen at Universal/EMI, but if past is prologue, you know there is going to be less music, not more.

Senator KLOBUCHAR. Mr. Faxon.

Mr. FAXON. I do take Edgar’s point. I think there has been in restructurings and mergers certainly reductions in rosters. But I think this is somewhat of a different case. EMI went through a very difficult period several years ago under the ownership of Terra Firma private equity company. The roster was completely—was
virtually decimated. And over the last 2 years, we have rebuilt that roster, and it is an extremely effective one. And what Lucian has been very clear with our staff and with us is that his aim is to continue to build beyond that.

So we do not start with a fat, uneconomic roster, which is why rosters are reduced. If you have successful artists, you do not cut them out. You cut the ones that are not doing well. We are not in that situation. We are in the building mode. And I think our track record at the moment is extremely good.

So I take—Lucian will speak for himself, but I would take his word for it that he is going to invest more and increase the amount of artists on our roster.

Senator KLOBUCHAR. OK. Do you mind if I go on or do you want to answer as well, Mr. Grainge?

Mr. GRAINIGE. Yes.

Senator KLOBUCHAR. OK.

Mr. GRAINIGE. As I have been saying, Senator, for EMI, more investment, more music, more choice for consumers, more platforms, and I think the point that Roger made is absolutely spot on. Labels fight to keep successful artists, and also you fight to keep and nurture artists that you believe in that can be the successful ones of tomorrow. And I said it actually in my opening statement. The company is on a really much greater sounder footing than it was probably 18 months to 2 years ago, and I am absolutely determined to build on the success and on the platforms, the music platforms, the artists that are signed within the company, to take them to the next level and to take all the stakeholders in the entire creative process to the next level and give them certainty and give them support and give them investment.

Mr. AZOFF. I think from the management perspective, artists will be happy that EMI is going to be in a period of spending more, but also in the independent sector, which has been growing, a Calvin Harris at Ultra Records, a Jason Aldean at Broken Bow Records, Joe Walsh last week with a number 12 debut on Concord Records, that, you know, having less majors will embolden artists to take more shots with independent labels, and I think it will cause independent labels to take more risks also.

Senator KLOBUCHAR. The second and last question I will ask, and I will put some more in the record, is just how this merger could impact retailers. Why do I care about this? We are the home of Target and Best Buy in Minnesota, and I care about it for our customers as well. And there are some that say that this could significantly impact negotiations with physical music retailers that I think are very important to the music business and had a hard time in recent years, and then others say that obviously they believe it would not have any effect on negotiating leverage. And if you could, maybe just one person on each side could give me an answer to that. Mr. Grainge.

Mr. GRAINIGE. If we do not have strong, committed music retail, then the physical music market will disappear even more than it has done. There are no small Mom-and-Pop kind of stores. So many of the individual specialist chains have unfortunately gone out of business. If we do not sell to them, if they do not carry our music on their shelves, then we will go out of business. So we are abso-
lutely desperate, whilst this market is still as high as 50 percent on physical, to do whatever we can to support the Targets and the Best Buys.

Again, I feel very strongly about that.

Senator KLOBUCHAR. Thank you.

Mr. Bronfman.

Mr. BRONFMAN. Yes, so Lucian keeps saying how much he wants to support both digital and physical retailers, and I have no doubt that that is true. I think the issue is on what terms. And, again, with Universal having the market power that it does, it obviously significantly increases its negotiating power with WalMart, with Best Buy, with Target. It will seek and will receive, as it has in the past in other circumstances, a disproportionate share of promotional opportunities, a disproportionate share of those companies' marketing dollars, et cetera.

So it is not that I think a Universal/EMI would fail to support a WalMart, a Target, or a Best Buy. It is what happens in that support and how WalMart, Best Buy, and Target allocate their dollars to the small amount of music sales that they have currently. I think that is the issue, and that will result either in less sales for Warner and Sony or higher prices for consumers, or both.

Mr. GRAINGE. Can I just, if you do not mind, Senator?

Senator KLOBUCHAR. OK.

Mr. GRAINGE. That is not the business world I live in. The sheer thought that we can have retailers stock something that people will not go in and buy and take it off their shelves is insanity. So we have to provide music to them, and they will only take music that they think they can sell; otherwise, they will sell Pepsi-Cola or they will sell something else, and they will move on.

Mr. BRONFMAN. But to be clear, I am not suggesting that that music will not be on the shelves. All I am saying is one has to think about the terms on which it got on those shelves and the terms on which other music that also would like to be on the shelves has to take as a result.

Mr. FAXON. But can I say, let us understand, Best Buy and Target—music is a very small part of—if you take WalMart, Best Buy, and Target, music represents less than 0.3 percent of their turnover. If we as an industry or even a significant player try to raise prices in a way that is not going to benefit—is going to reduce demand and, therefore, reduce turnover per square foot, what is going to happen? It is a very simple thing. And so they will resist, and we have to supply at the terms that they will accept. And we are looking—these stores, they look at their square footage and say, “What is my turn? What is my profit retention?” And if music is not providing it, they put something else in. We know that, because shelf space has vastly reduced in our industry. And our prices in the physical world have declined, and they continue to decline even to this day. So I think this is a red herring, frankly.

Mr. BRONFMAN. If I could just say, I think I agree with much of what Roger said. It is just that he did not respond to anything that I had said. I did not talk about Universal/EMI raising prices. I simply said that in terms of how much marketing dollar Target allocates to music, more of that music allocation will go to Universal/EMI. In terms of the floor space that they allocate to music, more
of that floor space will go to Universal/EMI. In terms of the merchandising dollars that they allocate to music, more of that will go to Universal/EMI. I think that is inevitable and absolutely true.

Senator KLOBUCHAR. OK. Well, thank you very much. I had some other questions on digital distribution and other things that I understand have been asked, and so thank you and we will submit some more questions for the record. I appreciate all of you being here and thoughtfully answering these questions.

Thank you.

[The questions of Senator Klobuchar appears under questions and answers.]

Chairman KOHL. I just have a brief question and maybe a single question from my colleague.

Mr. Faxon, if EMI is profitable and its prospects are very strong, as you said last year, then why should it be sold to its top competitor? How is that in the public interest?

Mr. FAXON. Well, it was not really put to me that way. What was put to me was that Citibank felt that it should put the business up for sale, and it is Citibank’s obligation for its shareholders—and the U.S. Government is one of those—to sell it at the best possible price. And Universal came forward with the best possible price and, therefore, it is the owner.

Chairman K OHL. Yes, I understand that as a business proposition, but in terms of the public interest, which is what the FTC is looking at right now, if your business is profitable and growing in the public interest—which is not the only interest to be considered—why should we sell it to your top competitor?

Mr. FAXON. I do not think—pardon me if this is sort of splitting hairs. I do not think it is not in the public interest. In other words, the word “anti” in “antitrust” implies to me that it is a bad thing for it to happen. I do not think it is a bad thing to happen. There are many scenarios that I could map out which I think would be good things to happen, but none of those are available. And so this is—I do not think this transaction is a bad thing.

Chairman KOHL. How are you going to profit personally in the event that this goes through?

Mr. FAXON. I am going to lose my job.

Chairman KOHL. In a comfortable manner?

[Laughter.]

Mr. FAXON. I hope so.

Chairman KOHL. All right. Finally—and then Mr. Lee—Mr. Bronfman, would it be in the public interest for this deal in its current state not to be done with Universal but, rather, to be done with Warner?

Mr. BRONFMAN. I think it is not in the public interest, Senator, for this deal to be done with Universal. I think any other deal will receive its own scrutiny, but on the face of it, the largest company in the industry becoming this much larger is wrong and it is not in the public interest.

Chairman KOHL. Senator Lee.

Senator L EE. I just have one more question. This one is for Mr. Azoff.

We have had a lot of discussion today, Mr. Azoff, about market power, and I just wanted to give you a chance to sort of wrap up
on this one. Tell me, in your opinion, will the consolidation of Universal with EMI likely bring about a set of market conditions that will result in harm to consumer welfare, for instance, in giving the new combined merged company the power to dictate prices, to determine the fate of new distribution channels, or the power to dominate and potentially foreclose sequential contracting arrangements?

Mr. AZOFF. I think their power will be virtually the same as if the transaction did not go through, and, again, I would like to just say we are kind of riding a big wave across the business that will have far more impact than this merger possibly could.

Senator LEE. Thank you very much.

Chairman KOHL. We thank you all for coming. It has been an interesting hearing, and I think it has cast a lot of light on this deal and on your industry. Your journey has been fruitful, and we appreciate your coming.

Thank you so much.

[Whereupon, at 4:37 p.m., the Subcommittee was adjourned.]

[Questions and answers and submissions for the record follow.]
QUESTIONS AND ANSWERS.

Sen. Kohl’s Follow-Up Questions for the Record for Hearing on

“The Universal Music Group/EMI Merger and the Future of Online Music”

For Irving Azoff

1. What’s your view of the health of the music industry today? Do you agree with the view that the music industry is in such poor health that consolidation is necessary? Why or why not?

Our industry has been turned on its head over the last decade. To prepare for the future of music, we need strong leadership, executives with vision and creativity, and investors committed to the long haul. That is why I am so delighted that Universal is acquiring EMI.

The music industry is half the size it used to be: down to $7 billion in 2011 from nearly $15 billion in 1999. In the week after the hearing, Standard & Poors observed that despite signs of stabilization over the past 18 months, the industry remains volatile. S&P expects continued physical sales declines over the intermediate term. No business executive would think that those facts describe a healthy business – but hopefully it is one that has survived the worst and is poised for modest growth and perhaps even a recovery.

As I stated in my testimony, it would have been great if EMI could have made a go of it on its own. But the recession, piracy, and the facts surrounding Terra Firma and Citi combined to make that impossible. The aura of uncertainty made EMI a risky place for an artist to sign new acts, and even harder to keep proven winners. With Universal taking over, and their commitment to deploying resources to resurrect Capitol Records, there will actually be another record company for artists to explore, if they want to. As I see it, it is not one less company – it is one more choice.

2. At the hearing, Martin Mills argued that this Universal Music/EMI merger would harm independent labels like the one he owns because it will impede their ability to compete with the major labels to promote new and diverse artists. What’s your view of the merger’s likely effect on independent labels?

I strongly disagree with Mr. Mills. I work with acts big and small, some that are household names and some who should be but just haven’t yet gotten there yet. Let me be very clear – none of them have to sign to a major label anymore. In fact, independent labels are capturing more and more market share every year – it’s grown from 23% up to 30% in the last decade.
Majors and indies compete vigorously to sign talent. And the decision on who to sign with comes down to chemistry, relationships, and confidence that the team you sign with will be right beside you throughout the entire journey. So most artists sign with the entity that gives off the right vibe, or the manager with whom they connect, or an agent who has experience in the genre, or has been down a relevant trail in the past.

For some artists, a major label partner makes sense, for others an independent is the best choice. For others still – I argue they need no label at all. And timing is important – the same artist may work better with an independent at one point in their career and with no label at another. In short – healthy labels of all sizes make for a healthy industry.

3. In his opening statement at the hearing, Mr. Mills challenged your assertion that 40% of the artists affiliated with your management company were not on major labels. If you believe that Ms. Mills’s testimony is in error, please explain why.

“Back in the day,” artists needed label deals. We are no longer “back in the day.” Much of the discussion that took place during the hearing would not have taken place five years ago – and will seem quaint five years from now.

Today, given the new paradigm, artists have choices as to how they want to build their careers and get their music out to their fans. Online services have lowered the barriers to entry enabling bands to raise their own financing, market themselves, get placed on digital services, and collect their own royalties.

“Independent labels” become more of a force every day. A2IM, America’s Indie trade association, reports that indies represent over 30% of the US market – and 38% of digital sales. In March A2IM’s President told Billboard that, “indies [are] ahead of all the individual majors in market share.”

Several of the artists that Mr. Mills cited are only on majors now because they’re under contract. Every one of them, when they reach the end of their contracts, will contemplate not re-signing to a major. What the Eagles did in 2007 with their last record [“Long Road Out of Eden”] will become more the rule than the exception.

4. Do you believe there are any conditions that the FTC should place on the Universal Music/EMI merger, should the agency decide to approve it, and, if so, what are they?

Universal’s acquisition of EMI will have a positive impact on artists, indies, consumers and everyone who loves music. While remedies might be under discussion in the EU, and may be deemed appropriate for some European markets, I would not expect the FTC to reach the same conclusion for the US market.
Front Line Management (Irving Azoff)

1. Critics of the merger have suggested that the majors continue to have near complete control over the music industry, especially over emerging digital distribution models.
   - Do you believe the influence of the major labels is increasing or diminishing?
   - How do you foresee the proposed merger affecting the ability of independent labels and unsigned artists to access the market?

I believe the role of major labels has diminished greatly – and that the trend will likely continue. I work with acts big and small, some that are household names and some who should be but just haven’t gotten there yet. Most of them do not have to sign to a major label anymore. I have been told that independent labels are capturing more and more market share every year. And today, more than any time in history, artists are empowered to get their music to fans without the gatekeepers of the past.

For these reasons, I don’t believe Universal Music Group’s acquisition of EMI will impact the ability of independent labels or unsigned artists to access the market.

2. Some have suggested that the practice of sequential contracting, whereby a startup contracts with any one label and the other labels follow suit and agree to license, allowed iTunes and Amazon to enter the retail market. These critics are concerned that in the post-merger market startups will always be forced to approach Universal first, making Universal the gatekeeper for innovative digital platforms.
   - Will new distribution services always need the initial approval of Universal, or will sequential contracting that starts with one of the other labels still be a viable strategy for new services?

I spend my life in a business where we don’t know which artist will succeed, or which digital service will succeed, or which promotional approach will succeed, and many of us have different opinions on which to bet on.

I think that the platforms for distribution of music to consumers continues to grow in many different ways, and many are not necessarily contingent upon initial approval from Universal or any other major label.

3. The concentration in the music industry has steadily increased over the past several decades, but the cost of music is close to what it was fifty years ago. In 1962, a single could be purchased for $1.00, which today would be about $5.00, compared to $1.29 on iTunes today. Movie tickets, on the other hand, cost around 50 cents in 1962 but can cost as much as $15 today.
• How does the historical pattern of consolidation coupled with decreasing prices comport with the argument that increased market concentration in the industry will raise the price of music for consumers?

As you point out, Senator, history shows that as the industry has consolidated, prices have decreased, not increased. I see no basis for believing that further consolidation will somehow reverse this trend.

4. Critics worry that if this merger results in undue market power for Universal it would allow that company to bully artists in negotiations and to seek higher prices for songs.

• Can you explain the role of labels in negotiating with artists and retailers and whether this might be the case?

• If labels don’t exert power over retailers, what good are labels to artists and why do artists continue to cede significant rights to sign on with a label?

In exchange for the rights granted to the labels, labels have historically provided a variety of services beyond any form of power over retailers that they may or may not have. They include A&R creative services, marketing services and promotion — all important to the artists big and small, and for the latter, providing the finance to many new artists is an additional benefit.

Labels “bullying” artists is not generally successful in my experience. The various majors and indies often compete for the same artist so it tends to be much more “wooing” than “bullying.” This business is about chemistry and relationships, and confidence that the team you sign with will be right beside you throughout the entire journey. So most artists sign with the entity that gives off the right vibe, or the manager with whom they connect, or an agent who has experience in the genre, or has been down a relevant trail in the past.

That tendency is intensified because artists have an increasing variety of choices. Artists still have the ability to obtain representation by lawyers, personal managers, business managers, and agents to protect them from unfair contract terms.

5. One of the important elements of a merger analysis under our antitrust laws is to define the relevant market. In this merger, regulators are likely to define the market according to either revenues from music distributed by labels or revenue from music owned by labels. Universal would prefer a market definition that excludes distribution because it provides distribution services for a large portion of the independent market.

• As digital sales increase and physical sales decrease, will independent artists and labels continue to contract with Universal for distribution? How will that affect the breakdown of market shares?

• Do you believe that online music in the form of services other than digital downloads, services like Spotify, are a substitute for CDs such that a person
facing an increased price for a CD would be comfortable turning instead to an online music service?

A key reason for independent labels and artists to enter into distribution contracts with the major labels is to access the physical warehousing and related infrastructure for physical distribution. In many instances, the independent labels undertake their own sale functions direct with retailers. In some instances, like WMG, the warehousing and pick, pack, ship functions are contracted out by the majors themselves. As the proportion of physical distribution continues to decline, fewer Indies will rely on major labels for distribution, and regardless, it does not seem to me to be relevant to the determination of the meaningful market share of one of the major label groups. By excluding the distributed elements, the market share calculation will more accurately reflect a label’s market share.

Clearly, the growth of the alternative platforms of delivering music to consumers has already impacted the volume of physical sales and the pricing of CD’s, and the trend of substitution is likely to continue.

6. The merging entities have assured that this acquisition will benefit the industry, artists, and consumers.

- Do you think this merger gives greater negotiating power to the majors that could limit artists’ ability to obtain favorable terms in their contracts?

No, I do not, for reasons stated above.

7. One of the efficiencies that can result from a merger is increased productivity resulting from more effective utilization of assets. You mentioned in your testimony that EMI has had a rough go lately and that Universal might be able to make better use of their catalog and artists.

- Can you expand on how you see EMI’s artists benefitting from the merger?

First, as I noted, UMG’s investment of capital and expertise will reinvigorate EMI, making it a real choice for artists once again. Second, by sharing the backroom functions of a label the acquisition will result in efficiencies that will allow more resources to be devoted to artist investment and development. Third, once EMI is operating in an era of greater certainty, artists will see the EMI imprints as more viable and competitive options. Finally, I believe Universal intends to maintain and build upon EMI’s key cultural assets, including their catalog – which is exceptional news for those artists whose works are included in that treasure trove.

8. Some opposed to the merger are concerned that Universal will be able to negotiate with online distributors for deals that over-represent its market share.

- If Universal is able to negotiate better deals, will independent artists suffer?
No. There are many aspects to a deal with a digital music service. And there are many ways a company could reach terms they find attractive that have nothing to do with their market share. Independent artists are well represented in negotiations with online distributors via Merlin and other services that function as an umbrella for independents.

9. We in Congress are greatly concerned with the prevalence of online piracy and its impact on our economy.

- From your perspective, what has been the effect of piracy on the recorded music industry?

As I mentioned during the hearing, piracy has had a devastating impact on artists. For example, an artist I started with at the University of Illinois 40 some years ago retired about 20 years ago. His earnings from his artist royalties in his writing and publishing were around $400,000 a year. Traditionally in the industry, that would go up every year. He came to see me recently and his earnings from this very active catalog have dwindled to $68,000 a year. The only place you can point to is piracy because the catalog sold steadily before royalties fell as pirate sites became rampant.
Questions for Edgar Bronfman, Jr.

1. **Distribution Channels** – Some observers have suggested that because of the many distribution platforms that exist in today’s digital age, gains in market share in the music industry may not necessarily lead to the same anti-competitive concerns they did in the past.

Mr. Bronfman, please explain why you believe this increase in distribution platforms is not sufficient to counterbalance the market share of a combined Universal/EMI if the merger goes through?

If current trends continue, I fully expect to see a proliferation of music distribution platforms, and therefore more choice for consumers among services, with a wide range of formats and price points. However, if the Universal/EMI merger occurs, this dynamic transformation of the music market would be slowed or derailed. New services would face the innovation-stifling market power of a “supermajor” that would control market entry. The greater the number of new services that attempt to launch, the greater the problem. An increase in the array of digital music providers seeking content deals would not counterbalance Universal/EMI’s ability to exert its power to obstruct the plans of, or extract onerous terms from, new distributors, but would only magnify the incentive to abuse that power.

It is important to understand that each new service in the future will be extremely dependent on Universal/EMI for content, and will thus face enormous leverage in contract negotiations. For most new distribution platforms, record labels negotiate comprehensive agreements with digital music services. An agreement between a major label and a digital music service includes a broad range of provisions – including price, term, territory, description of service, content commitment, consumer data, advances, royalty reporting and product promotion – shaping the characteristics of the business models and consumer offers under which such services go to market.

The “sequential negotiation” paradigm I described in my testimony – where momentum builds in content agreement discussions one deal at a time until all four majors are onboard – works today because no major is so large that it can generally block a service from launching by withholding its catalog. It is usually the case in the current environment that start-up services gaining the support of three majors can get the hold-out to eventually go along in most instances, any three majors, in combination with independents, are sufficient for a new service to credibly threaten to launch without the hold-out. Further, the competitive balance that currently exists also helps new digital music services resist being forced to accept onerous deal terms.
The proposed merger would substantially increase the size of Universal/EMI relative to Sony, Warner and independent record companies; the largest label would become almost as big as the remaining two majors combined. As a result, new music services likely would view Universal/EMI as the barrier to entry and approach the negotiation with Universal/EMI as the only one that mattered. And, the post-merger size of Universal/EMI—with its status as a “must have”—would give it leverage to drive its own supra-competitive terms, because there would simply be no credible threat that a service could launch without it. Universal has shown a propensity to use its existing market power to try to exert leverage over new services in a number of instances cited in my testimony, impeding innovation and taxing their economics in a way that forebodes what the Universal/EMI merger, if permitted, would effectively institutionalize.

In fact, a more diverse distribution ecosystem might actually increase the deleterious impact of Universal/EMI’s market power. While the music distribution sector, driven by the evolution of technology, might become more competitive in the future, if this merger takes place, the recorded music industry would become much more concentrated. This “asymmetrical” development, where demand for content deals expands while supply of music copyrights becomes much more constrained, would exacerbate the anti-competitive impact of this proposed merger. Proliferating start-ups in new service categories would be forced to bid against each other for the indispensable music catalog of one supermajor, which holds the fate of such services in its hands.

2. Future of the Music Industry - One of the most important and interesting dynamics in evaluating the merits of this merger is the evolving nature of the music industry. We know the history of the industry, and we know the landscape of the industry today, but where do you think the future of the music industry will lie? How does your answer to that question impact our analysis of this merger?

Last year the industry reached an inflection point, according to SoundScan, as digital downloads accounted for more than 50% of all recorded music unit sales in the U.S., overtaking physical unit sales for the first time. As an industry, we are figuring out how to give consumers what they want, digitally, and, as a result, by crossing this tipping point, we are reversing a more-than-decade-long negative trend. A report just issued by PricewaterhouseCoopers forecasts that the continued rise of subscription-based streaming music services and digital downloads are projected to help the U.S. recorded music market grow by 17.9% over the next five years. The proposed Universal/EMI merger must be viewed against this backdrop. This is the worst possible time to allow Universal to gain control of the industry by buying market share and market power.

In the current environment, new distribution models are emerging all the time. No one can tell where this transformation may ultimately lead us. But if the coming decade is anything like the last, it will continue to be revolutionary. While digital downloads have defined the first decade of the music industry’s digital transformation, the most recent area of innovation has been in the form of music lockers and streaming services that provide

1 See PricewaterhouseCoopers, Global Entertainment and Media Outlook, 2012-2016, at 269-272.
alternatives to download stores. "Jukebox in the sky" services offer consumers the choice of unlimited network access beyond their existing library to millions of music tracks stored in the cloud, typically in exchange for a monthly fee. Many observers believe these new cloud-based service models will define the second generation of digital music.

While it is clear that the future of the music industry will be driven by digital innovation, and cloud services appear to be the "next big thing," the fact of the matter is that we don't know exactly where the next major breakthrough will come. Spotify, YouTube, iTunes... each made a big impact on the music business over the past decade, but no one knew before they launched how important they would become. These services were all regarded as highly disruptive at the time they were seeking content deals from the music industry. One thing the digital revolution has taught us across industries is that dominant companies fear disruption. One dominant supermajor may well have blocked any one of the disruptive innovations powered by companies such as Spotify, YouTube or Apple before they launched. While we don't know exactly what the future may hold, we have observed that the bigger the company, the greater the fear of disruptions to the status quo.

And so, with respect to the forthcoming developments in the music business and consideration of this proposed merger, I believe we are at a crossroads in the record business. We face two visions of the future. In the first, we see a world where consumers can get all the music they want, any way and anywhere they want it and at an affordable price. A world where a person with a transformative idea for a digital music service or product can bring it to market under fair and reasonable terms. But we also face a second vision: a darker one. A world where one company - Universal/EMI - sets the prices, terms and conditions for future digital evolution. Where Universal/EMI would stand as gatekeeper between consumers and choice, throttling innovation and extracting a heavy toll every step of the way.
Questions for Edgar Bronfman, Jr.

1. In considering whether to license Warner Music’s music to new online distributors, do you consider the effect on Warner Music’s existing business model, and whether these new distributors will cannibalize your business? Would you expect Universal to make the same calculation in deciding whether to license its music to new distributors?

Yes. Warner considers whether and how a new digital service will affect its existing business in determining whether and on what terms to provide its music. Warner often does financial modeling to assess whether a new service is likely to be viable and capable of meeting revenue expectations. On occasion, Warner commissions research to determine the behavioral habits of music consumers, the service features they value and the types of services for which they would be willing to pay. In addition, Warner considers how a new service relates to piracy (including whether the service has in place service usage rules that deter unauthorized use of content and whether it offers a superior product to piracy).

As part of its analysis, Warner typically does consider whether and to what extent a new service would cannibalize existing services. To that end, when entering into content agreements, Warner typically seeks to ensure that each digital audio distribution service functions as a distinct product, offering a distinct revenue source, and the provisions that Warner includes in these agreements are designed to limit the financial risk to the extent the service substitutes for other revenue sources.¹

I believe it is likely that Universal, like Warner, assesses the effect new digital services may have on its business, and thus that Universal takes into account the potential for cannibalization and other factors. I also believe that Universal has encountered business models it prefers and others about which it is less enthusiastic. As I stated in my written testimony on page 7, in the current environment, once three majors have come on board, the fourth has a difficult time remaining a holdout. As a result, services launch and consumers can sort out which “win” and which “lose” in the marketplace. Post-merger, however, Universal/EMI would be in a position to substitute its self-interested judgment for that of consumers or of the market. Its interest in preserving the status quo and existing revenue streams will dominate the market and potentially disruptive innovators will be unable to gain a foothold in the space.

Spotify, YouTube and iTunes were all services regarded as highly disruptive when they were seeking content deals from the music industry. One thing the digital revolution has taught us across industries is that dominant companies fear disruption. One dominant supermajor may well have blocked any one of these disruptive innovators. The bigger the company, the greater the fear of disruptions to the status quo.

2. In recent years, we’ve heard that the music industry is in bad economic health and some assert this as a reason that this merger should be allowed. Yet RIAA statistics show that the music industry shipped over 1.8 billion units of both albums and singles last year, nearly double the units shipped a decade earlier. Music sales increased for the first time since 2011, with digital single sales up 13%. A report just issued by PriceWaterhouse Coopers predicts increasing digital music sales will cause the U.S. recorded music market to grow by 17.9% over the next five years. In light of these statistics, do you think the music industry is in such poor health that it needs further consolidation to survive?

No. The music industry is not in such poor health that it needs further consolidation to survive. As I stated in my written testimony (at page 3), the RIAA recently reported that in 2011 total U.S. music shipments were up for the first time since 2004, the number of users of music subscription services jumped 19% and digital single sales were up 13%. Moreover, other areas of revenue continue to grow rapidly. Synchronization and digital performance licensing revenue also increased by 4% and 17% respectively in 2011. And we were encouraged when we saw the PricewaterhouseCoopers report which concluded that the continued rise of subscription-based streaming music services and digital downloads are projected to help the U.S. recorded music market grow by 17.9% over the next five years. As I testified, the industry has turned a corner and is returning to growth.

To that testimony, I would add the following. Boyd Muir, the global CFO of Universal Music Group, said in November 2011, “[w]e are approaching the inflection point for the recorded music industry.”2 According to the Billboard report on his comments:

While he acknowledged that it is not here yet, he predicted it would arrive sooner rather than later. Pressed by an analyst for a more precise forecast, he predicted the inflection point could come towards the end of 2013, although “it might be a little bit sooner” or a bit later. Particularly signs from the big U.S. market are encouraging, Muir said.

More recently, on January 23, 2012, at the presentation of IFPI’s Digital Music Report 2012, Rob Wells, Universal’s President of Global Digital Business, declared that “[t]he future is looking extremely bright. Has the industry turned a corner? I’m definitely more positive now

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than I’ve ever been ... I think that 2013 is probably a safe bet.”

In my view, it is a misconception to believe that the consolidation brought about by the proposed Universal/EMI merger would be beneficial to the recorded music industry. The music industry is currently competitively structured, with four majors and many smaller companies. All four major companies are important but none of them have the power to tip the market in their favor (although Universal may be close already in recorded music). There is absolutely no reason to believe that the music industry would be in better health or that consumers would benefit if Universal and EMI. On the contrary, the proposed merger would obliterate the current fragile competitive dynamic by creating a “supermajor” in recorded music with the ability to demand terms and conditions that inhibit competition, constrain innovation and harm consumers.

Also, I would add that it is a misconception to believe that EMI is a failing company that would have exited the market in the absence of the proposed merger with Universal. That could not be further from the truth. In February 2011, Roger Faxon made it clear that EMI had “the strongest balance sheet in the business.” And a company that counts among its artists Coldplay, Katy Perry, Lady Antebellum, Keith Urban and the Beatles can hardly be called a “non-factor” in the business. In addition, EMI has a proven record of supporting innovation, being at the origin of the move towards DRM-free music and being a huge advocate for global rights management.

A contracting marketplace, in any event, should not alter antitrust concerns. As I indicated above, the music business has turned the corner. Music is also is a key player in a much larger, robust content-technology value chain – which has been a booming sector for the last decade. More generally, however, regardless of the sector, antitrust analysis should not materially alter when a market is stagnant or declining. As the Department of Justice’s then Deputy Assistant Attorney General for Economics in the Antitrust Division remarked in 2009: “competitive markets are superior to monopolized or cartelized markets for economic growth and recovery.” The fact that an industrial sector is facing structural or cyclical market declines does not rewrite microeconomics or obviate the need for competition.

3. (a) Does Warner Music include in its market share calculation the independent labels it distributes? If so, why does it do this? Is it because it negotiates the pricing and terms for these labels with online distributors and physical CD stores?

(b) Do you believe that a record company’s market share should include the independent labels it distributes? Why or why not?

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(a) Yes. Warner has historically included in its market share estimates both the labels it owns and the independent labels it distributes. It has been standard practice in the industry for other majors to do the same thing. See response to question 3(b) below for more detail.

(b) Yes. In line with well-established industry practice, a record company’s market share should include the independent labels it distributes.

Each of the majors, in addition to the labels it owns, is party to a large number of so-called “distribution agreements” between its distribution arm and third-party record labels. While the precise terms of these agreements are often non-public, they are likely to share some similar features. A major is granted the exclusive right to distribute (and sometimes market or provide other services for) the third-party record label’s repertoire in exchange for the major receiving a distribution fee typically calculated as a percentage of net sales. In many cases, the distribution agreements will convey both digital and physical distribution rights; in other cases, only physical rights. Where the major is granted physical distribution rights, sometimes the major will also be granted the exclusive right to manufacture the distributed label’s physical records at pre-negotiated fees and such fees are deducted by the major from the net proceeds payable by the major to the distributed label.

For the growing universe of non-download digital accounts (e.g., Spotify, Rhapsody, iTunes Match), the major has the ultimate say on pricing of the non-owned labels it distributes because pricing is governed by the contractual arrangements negotiated between the major and the non-download digital account. Even where the independent label maintains the ultimate say on pricing – as can be the case with digital download accounts such as Xbox Music and physical accounts such as Anderson (which purchases for Wal-Mart) – the major, in actuality, has a great deal of influence on pricing. The major controls and cultivates the relationship with the retailer and the major has access to greater resources when it comes to market analytics. So when it comes to pricing decisions by the distributed label that are not album-by-album or track-by-track decisions (e.g., how to generally price single-track downloads within the available suggested retail price categories ($0.69, $0.99 or $1.29), whether or not to participate in a particular catalog campaign at Best Buy, whether or not to participate in an across-the-board discounting program at Amazon), the distributed label looks to the major for guidance or the major proactively provides guidance to the distributed label.

So, in summary, there is only one element of distribution agreements – the fact that the independent label sometimes has final say over pricing on download and physical accounts as a matter of contract – that can even colorably be used to argue in favor of disregarding distributed market share in measuring market power. But even when that is true, the argument that the independent label is actually an independent economic actor is based on form over substance and is disingenuous and opportunistic at best.

Finally, as I noted in my oral testimony, until this proposed merger was announced and it became expedient for Universal to claim a smaller market share, Universal has consistently included the independent labels it distributes in its own market share estimates. That is the metric Universal has used when talking to potential purchasers of Vivendi shares; that is the
metric it has used when seeking better economics from the Copyright Royalty Board; and most importantly, that is the metric it has used when negotiating the terms of its digital deals.

4. At the hearing, Martin Mills argued that this Universal Music/EMI merger would harm independent labels like the one he owns because it will impede their ability to compete with the major labels to promote new and diverse artists. What’s your view of the merger’s likely effect on independent labels?

Universal’s proposed acquisition of EMI would make Universal into a “supermajor,” almost as big as the remaining two majors combined. The size of Universal/EMI’s catalog will enable it to become an absolute “must have” with regard to all retailers. This “must have” status would afford Universal the ability to demand a supra-competitive premium, both in terms of revenue and in terms of promotion, from the retailers.

Faced with Universal’s disproportionate demands, retailers would have no other choice than to either reduce the revenue and promotion opportunities available to Universal’s competitors, particularly the independent labels, or to increase retail prices. The independent labels do not have the same bargaining power with the retailers as the majors. While the content of the majors is vital for the retailers’ success (and particularly the digital retailers), the content of the independent labels is not necessary for these retailers to offer a rich experience to their customers. Independent labels do not have the same resources as the majors to promote and distribute, on a national scale, artists who appeal to mass audiences. Therefore, it is likely that, faced with the onerous terms dictated by Universal, the retailers will allocate the remaining revenue and promotion opportunities to the surviving majors first, to the detriment of the independent labels. Ultimately, this is bad for consumers as it will restrict choice and innovation.

We may well have already seen previews of this type of harm being done to independent labels due to disproportionate revenue and promotional allocations extracted by Universal, even at its current size, in agreements with eMusic, imeem, Microsoft’s “Zune,” Nokia’s “Comes with Music,” RIM’s “BBM Music” and Spotify.

5. While new technologies are obviously very important in the music marketplace, about half of the music industry’s revenues today still come from the sale of physical CDs, most in chain stores like Wal-Mart or Target or via Internet web sites such as Amazon. Does reducing the number of major record companies from 4 to 3 carry the risk of higher prices for consumers when they buy physical CDs?

If this merger goes through, Universal/EMI would be a “must have” and, in some cases, a “need only” supplier for physical music distributors. “Brick and mortar” retailers have limited shelf space available for CDs. Post-merger, Universal/EMI would have a commanding position in the top chart hits that brick and mortar retailers must carry (i.e., 51 of the titles on the Billboard Top 100 chart and 45% of SoundScan’s top seller albums in 2011). As I testified, this extraordinary control of the most important inventory would likely allow Universal to offer less support to retailers, to increase its rivals’ cost of distribution and to demand more favorable
promotional terms. The economic result is likely to be higher prices to consumers. I think that this would be true of both large and small brick and mortar retailers.

6. Do you believe there are any conditions that the FTC should place on the Universal Music/EMI merger, should the agency decide to approve it, and, if so, what are they?

Any discussion of conditions needs to start with two fundamental principles.

First, any remedy needs to fully address the likely competitive harm from the merger. In particular, any remedy short of blocking the merger must be prompt, certain and effective. Second, as the FTC’s Bureau of Competition has recently reaffirmed, structural relief is preferred over behavioral relief in horizontal mergers. Behavioral remedies, to the extent they are appropriate at all, should only be used as a supplement to divestitures.6

It is unlikely, given the type of competitive harm this merger is almost certain to cause, that the merger can be remedied through selective and limited divestitures or through behavioral relief.

As I explained in my written and oral testimony, innovative online distribution platforms have come about because each of the four majors can sponsor innovation, and none is currently large enough to block the launch of a new service. However, Universal has already been able to extract supra-competitive terms from certain new models. Thus, any remedy would have to maintain the rough competitive balance in the industry by preventing Universal – already the largest label – from becoming significantly larger.

Behavioral remedies are unattractive for many reasons, as the FTC itself has recognized. First, the FTC is not set up as a regulatory agency. It is not, and should not be, in the business of ongoing oversight of conduct in the marketplace. Indeed, to the extent that the FTC is market-oriented, behavioral remedies can be perverse, in that they limit the ability of a firm to make market-based decisions, and they are by necessity applied only to the merged firm and not to its competitors. Second, as has been pointed out in other testimony, a recent retrospective study of merger remedies has suggested that horizontal mergers subject only to conduct remedies have resulted in much higher price increases than mergers subject to divestitures or out-and-out prohibition.7 This confirms the long-standing practice at the FTC not to use behavioral relief as a stand-alone remedy in horizontal mergers like this one.

Because neither selective divestitures nor behavioral relief are likely to be effective, there is no reason to believe that some combination of the two would be more effective.

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Senate Committee on the Judiciary
Subcommittee on Antitrust, Competition Policy and Consumer Rights
Hearing on “The Universal Music Group/EMI Merger and the Future of Online Music”
Questions for the Record by Senator Mike Lee

Questions for Edgar Bronfman, Jr.

1. Some are concerned that the new Universal will leverage its market power in its negotiations with retailers like Apple and Wal-Mart in order to raise prices.
   
   • Do record labels have pricing power in their negotiations with retailers?

   An agreement between a major label and a digital music service ultimately includes a wide range of provisions – including price, term, territory, description of service, content commitment, consumer data, advances, royalty reporting and product promotion – shaping the characteristics of the business models and consumer offers under which such services go to market. In addition, record labels often collect a share of a digital service’s advertising revenue or other revenue derived from the service. Finally, record labels also negotiate for valuable promotional placement or other in-kind services from the distributor. All of these dimensions are relevant to what the consumer ultimately pays. In many cases, the pricing decisions made by labels are carried through directly to consumers.

   As I stated in my testimony, the environment today is generally competitive. However, Universal has reportedly sought to obtain, and may have already succeeded in forcing digital service providers to agree to revenue allocations and/or promotional opportunities disproportionate to Universal’s market share or actual usage on a particular service. I provided a number of examples at page 9 of my testimony. Universal’s head of digital also was quoted recently indicating that Universal has negotiated more than 49 exclusive deals globally, where the company has foreclosed its competitors from the market for a period of time. ¹ I believe there are other examples as well. It strikes me as likely that Universal/EMI’s power to extract such terms would be significantly greater post-merger.

   Apple is obviously an important digital retailer but it is certainly not immune to price increases. In 2009, iTunes introduced tiered price points for single tracks after contracts were renegotiated, and music companies were able to profitably raise pricing on the vast majority of single-track transactions by 30%, with retail prices increasing from $0.99 to $1.29. It is important to bear in mind that most of iTunes’ music revenue is generated by the sale of singles, and the $0.99 track price had for six years been a core component of iTunes’ value proposition.

¹ Rob Wells Interview, http://www.youtube.com/watch?v=ZbAY9ApG5V (minutes 47-50) “We were live on that service [Singtel] done for 2 years... And now the other majors are in on that service... We’ll have fun... earn some cash for the artists and everybody and then we’ll let everyone else in. We’ve got 49 of these deals now.”
With respect to physical distribution, “brick and mortar” stores have limited shelf space available for CDs. Post-merger, Universal/EMI would have a commanding position in the top chart hits that brick and mortar retailers must carry (i.e., 51 of the titles on the Billboard Top 100 chart and 45% of SoundScan’s top seller albums in 2011). As I testified, this extraordinary control of the most important inventory would likely allow Universal to offer less support to retailers, to increase its rivals’ cost of distribution and to demand more favorable promotional terms. The economic result is likely to be higher prices to consumers. I think that this would be true of both large and small brick and mortar retailers.

2. Critics of the merger state that a post-merger market dominated by three firms would be vulnerable to conscious parallelism—that is to say, that with only three firms competitors will look at each other’s prices and implicitly engage in anticompetitive conduct.

- Do you agree with these concerns?

No. I assume that the reference to “critics of the merger” refers to Public Knowledge and Consumer Federation of America. While I respect what they have to say, what they describe has not been my experience. In fact, it has always struck me what a wide diversity of views and how little agreement there generally is among the companies in our business.

The concerns I have expressed about the proposed merger are not that there will be “conscious parallelism” if the merger occurs. Rather, my concerns are about the unilateral power that a single dominant firm would have post-merger. As I have explained in my testimony, Universal already has been able to exercise some degree of market power at its present size in the commercial terms it is able to extract from digital distributors. I have no doubt that its ability to unilaterally exercise market power would increase substantially if the merger takes place.

- Is this something that already occurs in the current market among the four major labels? Do you pay attention to what your competitors are doing?

My view is that most companies pay attention to what their competitors are doing, and that is a normal part of competition. But I do not believe that this is the same thing as “conscious parallelism.”

3. Critics have raised concerns about the effect of the merger on innovation. They worry that new companies requiring a broad catalog of songs will face hold-outs. Supporters of the merger counter that any incentive to hold-out is already present in the market, particularly for Universal, which by some estimates has 30 percent of the market and yet has been an active participant in startups such as Spotify.

- Do you see problems with hold-outs in the current market?
Yes. There have been some problems with hold-outs in the current market, which preview what we can expect to a much greater degree if this merger takes place and Universal becomes a “supermajor.”

It is usually the case in the current environment that start-up services gaining the support of three majors can get the hold-out to eventually go along; in most instances, any three majors, in combination with independents, are sufficient for a new service to credibly threaten to launch without the hold-out. And, the competitive balance that currently exists also helps new digital music services resist being forced to accept onerous deal terms. However, Universal has shown a propensity to use its existing market power to try to exert leverage over new services in a number of instances, impeding their innovations and taxing their economics, foreshadowing what the Universal/EMI merger, if it takes place, would effectively institutionalize.

Universal’s actions may have led to the bankruptcy of a well-capitalized new service called Beyond Oblivion when Universal failed to license the service, as well as forced the sale to Apple of a service called lala when Universal blocked lala’s proposed integration with Facebook. An example of Universal trying to dictate a new service’s business model by withholding its catalog was evidenced by the 2011 Deeezer judgment in a French court. Yet the impact of Universal’s existing exertion of leverage may be even more pronounced in forcing digital service providers to agree to onerous terms, often including allocations of revenue and/or promotional opportunities disproportionate to Universal’s market share or actual usage share on the particular service, as I mentioned above. To summarize and amplify what I covered in my testimony, Universal has reportedly sought to obtain, and may have already succeeded in securing such disproportionate allocations from services such as eMusic, imeem, Microsoft’s “Zune,” Nokia’s “Music with Music,” RIM’s “BBM Music” and Spotify.

These examples from the existing market demonstrate how important it is to consider not just the services that got derailed by a hold-out, but also the oppressive terms extracted from services eventually licensed by the hold-out. Universal’s track record on both counts is cause for heightened concern when contemplating the much greater power Universal/EMI would be able to exert after the proposed merger.

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Post-merger, the current dynamic could only get worse. One company, Universal/EMI, would hold the key to innovation. And if it gave a new service the go-ahead, it could insist on disproportionate pricing and other terms that would result in higher prices to consumers, unsustainably low margins for distributors, increased costs of doing business to competitors, or a combination of all three. By using its increased market power, moreover, Universal/EMI would be in a position to perpetuate its dominance moving forward, making it virtually impossible for the market to correct these harmful effects.

- Does your company attempt to hold out for supra-normal profits from innovative distributors?

No. While we negotiate aggressively, seeking to obtain fair market value for our music and related copyrights, and we attempt to protect ourselves from competitive disadvantage with respect to other music companies, we do not seek supra-competitive profits in the outcome of our negotiations with innovative distributors.

- Do you see any significantly increased threat of a hold-out occurring due to this merger?

Yes. The “sequential negotiation” paradigm I described in my testimony – where momentum builds in content agreement discussions one deal at a time until all four majors are onboard – works today because no major is so large that it can generally block a service from launching by withholding its catalog. Today, in most instances, any three majors, in combination with independents, are sufficient for a new service to credibly threaten to launch without the hold-out. Google Music is a good and very recent example of this. Warner has not struck a deal with Google Music, but the service has launched anyway. Start-ups can secure deals with a “super-majority” of music companies without the support of any one major, even Universal, and therefore most viable new digital services (though not all, as noted above) have successfully made their way to the market.

The proposed merger would substantially increase the size of Universal/EMI relative to Sony, Warner and independent record companies; the largest label would become almost as big as the remaining two majors combined. As a result, new music services likely would view Universal/EMI as the barrier to entry, and approach negotiations with Universal/EMI as the only discussion that mattered. Without Universal/EMI, a service simply could not gain sufficient traction to launch: there could be no ability for a service to secure deals with a “super-majority” of music companies without Universal/EMI. And, the post-merger size of Universal/EMI, with its disproportionate market share—its status as a “must have”—would give it leverage to drive its own supra-competitive terms, because there would simply be no credible threat that a service could launch without it. In sum, this merger would fundamentally restructure the industry around one supermajor, eliminate the existing competitive balance and completely derail sequential negotiation as a path to market for new digital services.
As noted above, Universal's past efforts to exert leverage may be a disturbing prologue to the innovation-stifling implications of the proposed merger. However, the concerns these examples raise are greatly amplified by the reality that in a competitively imbalanced post-merger market, distributors could no longer rely on sequential negotiation to effectively counter a hold-out position. It therefore seems certain Universal/EMI would use its supermajor market power not only to dictate the path and progress of innovation, but also the price innovators and consumers would be forced to pay for the provision of new digital music services.
Questions for Roger Faxon

1. Some have suggested that this merger is a 4 to 3. Others have argued that independents play a significant role and this merger is therefore more similar to a 5 to 4.
   - What role do independents play in the recorded music market and do you see them as, together, constituting a kind of fifth major?

The issue here is “market power” and whether a higher concentration of sales of recorded music in the hands of one player will consequently decrease competition to the detriment of consumers. As I said in my remarks before the Subcommittee, retail, both physical and digital, is characterized by a highly concentrated customer base which, in and of itself, would more than offset any effect of this combination on the retail price of music.

It is also important to recognize the demonstrable and substantial competitive constraint of pirate services. Consumer demand for commercially-available recorded music has become increasingly elastic as pirate music services have grown in availability, variety, and perceived legitimacy (particularly by younger consumers). Even if one ignores the many other constraints on the ability of a “major” to increase recorded music prices in any channel of distribution (e.g., the demonstrated ability and willingness of Amazon or Wal-Mart to substitute DVDs and other products for CDs in allocating shelf space), one cannot reasonably deny the evidence that pirate recorded music services constitute a substantial competitive constraint on major and independent recorded music companies and legitimate digital music services.

But even more than that, competition in the music market is not just limited to the “majors;” smaller record companies play a large and increasingly important role in our market. The so-called “independent” recorded music companies account for approximately 30% of recorded music, as large as, or larger than, each of the so-called majors. In addition, a number of those independent labels have joined to create Merlin, which they themselves often refer to as the “fifth major,” to license and distribute their music through digital channels. It has been estimated that Merlin’s share of those sales in the US is around 9%, roughly the same as EMI. Therefore, certainly in the digital segment of our market, even if the competitive set is defined very restrictively to include only established distributors, post-acquisition, there would be at least four substantial competitors with a large and dynamic competitive fringe.
2. Before the Citigroup acquisition, EMI was in serious financial distress, having accrued nearly $4 billion in debt. Some have argued that despite good leadership EMI’s role as a major player in the industry has slipped.
   - How viable was EMI before this proposed merger?
   - Should it still be considered a major?
   - Is EMI in need of additional investment?

When Citibank acquired EMI, it undertook a major recapitalization of the firm. As a result, our debt was substantially reduced and we regained our financial footing. As a consequence, EMI is a viable recorded music company today and, most certainly, remains a “major” recorded music company. However, the acquisition by Citi did not put an end to the speculation about its future. What EMI and its artists continue to need is stability. The viability of our business is based upon the confidence of our artists in our continued ability to help them develop their music and help them find fans to love that music not just at this moment but well into the future. In that respect, I am heartened by UMG’s commitment to invest in, and build, Capitol Records for the long term.

3. Much of the debate over market definition centers around whether the major labels’ distribution of independent-owned music should be included in the market share of the majors or in the market share of the independents.
   - Does EMI contract to distribute for indies?
   - Will those contracts move to Universal?

EMI Label Services provides distribution services to independent labels whose sales comprise less than 1% of recorded music in North America. Each distribution agreement between EMI and an independent label is individually negotiated and the terms of those agreements vary widely. Some independent labels contract with EMI Label Services only for digital download distribution, others solely for physical distribution, and some for both. In particular, independents are more likely to retain digital distribution rights and contract with EMI Label Services solely for physical distribution. Further, final pricing authority for both digital and physical distribution remains with the independent record label, not with EMI. Independent labels not only control pricing of their recordings, they also own the masters of their recordings, which allows them to move their entire catalog to a new distribution company when the term of the contract ends.

EMI Label Services has developed strong relationships with excellent independent labels and their artists. Although as the CEO of EMI Music, I am not privy to Universal’s plans for EMI Label Services after it acquires EMI, it is my understanding that most, if not all, EMI Label Services distribution contracts with independent labels can be transferred to Universal.
Senate Committee on the Judiciary
Subcommittee on Antitrust, Competition Policy and Consumer Rights

Hearing on “The Universal Music Group/EMI Merger and the Future of Online Music”

Questions for the Record by Senator Herb Kohl

Questions for Roger Faxon

1. In her written testimony at the hearing, Gigi Sohn stated that “With respect to digital music services, EMI Music has consistently been the first major label willing to take risks and innovate.” Do you agree with that? What has been EMI’s approach in considering new digital distributors?

I am very flattered by Ms. Sohn’s remark that EMI has “consistently been the first major label willing to take risks and innovate.” I certainly do believe that EMI has been both innovative and willing to take risks and that we have done a very good job of responding to changes in consumer preferences, market demand, and technology. While it is true that we often are among the earliest to embrace a new service, it would be inaccurate to suggest that we have consistently been the first to reach agreement with such services. We move with all deliberate speed to understand the implications of a particular service’s consumer proposition and business model. In each case, we consider the quality of the service, the revenue stream to EMI, its business model, and the sustainability of the economics for the digital service. Sometimes that is a relatively straightforward analytical process and, when it is, we move swiftly to reach agreement. However, with propositions that have no analog in the market, it takes longer to analyze and get comfortable with the implications. As you might expect, in that situation, it may well take some time to finally reach agreement.

It is critical to understand that for EMI – and, I believe, for all music companies – the future of our business rests on embracing these services. We want these services to succeed. They are the route to the consumers who have fled our traditional retail partners. They are the means by which we can revive the excitement and interest by consumers in the music we represent. They present a whole new way of creating value for us and our artists. So, we do not take this process lightly. But, we also have to understand that not all business models and consumer propositions are sustainable or beneficial. It is our responsibility to support those that have the potential to expand our market and eschew those that would corrupt that market.

2. In an interview you gave to the Los Angeles Times in February 2011, you stated that “EMI is actually very profitable overall. Our margins are the highest of any in the music business. We have a vision and an optimistic view of what our future looks like.” So if this merger was not approved, would not EMI be a viable independent business?

First, it is important to note that EMI Group is no longer what it was in February 2011: our music publishing division, which worked closely with the recorded music division, has since been sold to a consortium led by Sony. Nevertheless, as I testified at the Hearing, we continue to perform well, and I believe that, on any standard, EMI’s recorded music business is viable. I also testified, however, that Universal has presented a persuasive business case that its acquisition of EMI’s recorded music business will result in greater investment in, and broader opportunities
for, our artists, and other synergies and efficiencies that could benefit the combined companies and consumers. Because the proposed acquisition does not, in my view, present any significant threat to competition that would warrant an FTC objection or a court-ordered injunction, Universal should be allowed to achieve these benefits.

3. In recent years, we’ve heard that the music industry is in bad economic health and some assert this as a reason that this merger should be allowed. Yet RIAA statistics show that the music industry shipped over 1.8 billion units of both albums and singles last year, nearly double the units shipped a decade earlier. Music sales increased for the first time since 2011, with digital single sales up 13%. A report just issued by PriceWaterhouse Coopers predicts increasing digital music sales will cause the U.S. recorded music market to grow by 17.9% over the next five years. In light of these statistics, do you think the music industry is in such poor health that it needs further consolidation to survive? Are you asserting the poor economic health of the music industry as a reason for this merger? If so, don’t these industry statistics contradict the view that the industry is in poor shape?

I am sure you recognize the old adage that when it comes to numbers, understanding them is all about how they are presented. That is no more true than in this case. So let’s break down the numbers and see what they tell us. Specifically, in 2011, SoundScan reported 330.6 million albums and 1.27 billion digital track singles were sold in the US for total units of 1.6 billion. But, adding together albums and singles is like trying to add apples and grapes. Albums and singles are simply not equivalent. A typical album contains ten or more single tracks. And value roughly follows that pattern as well. So, the industry has established a way of making them comparable by converting singles in to albums at a ratio of ten to one. On that basis, the total of actual albums and album equivalents in 2011 is 458.2 million. Using a similar methodology for the unit sales, in 2001, the industry sold 769.1 million units (in albums and album equivalents). So the reality is that industry unit sales have actually dropped by more than 40% in just ten years, not doubled.

Equally, I think it is premature to predict that the recorded music industry is out of the woods just yet. Indeed, in 2011, the industry’s unit sales as counted by SoundScan showed a modest 3.2% increase over the prior year with physical sales dropping by 5.9% and digital sales increasing by 13.0%. But I am afraid that in the first half of this year, industry unit sales have been stagnant and in fact dropped by 3.1% in the second quarter. And if EMI’s experience is any measure, prices, and therefore value, continued to fall. All that is to say we as a business, and the recorded music industry, must continue the quest to find new ways of reaching consumers with the music it represents and to find innovative propositions to present to those consumers if it is ever going to be able to rebuild. As for the PriceWaterhouseCoopers report, I would only hope they are correct, but if they are as accurate in their predictions as they have been in the past, I would certainly approach these estimates with some caution.

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2 id.
Finally, I do not believe that market decline -- no matter how precipitous it has been -- is on its own a sufficient justification for consolidation. Consolidation will not determine whether our industry survives. As highlighted in my earlier testimony, the forces that have profoundly transformed recorded music will continue to threaten the music industry and will only grow stronger in the coming years. Although UMG has an admirable record of obtaining excellent results for its artists, UMG's acquisition of EMI Recorded Music cannot protect UMG, or the industry, from forces such as piracy, consolidation of physical sales in a very small number of big box retailers (none of whom rely upon music for even 1% of their revenue), and democratization of music through digitalization of content creation, promotion, and distribution. It is only through innovation in providing consumers with the music they want, in the way they want, that will lead to the recovery of this industry.

4. The merger's critics argue that it will leave the combined Universal/EMI with a 40% market share, and the three large record companies controlling 90% of the market. The merger's proponents argue that this market share computation is incorrect because it includes not just the music labels that the merged entity would own, but independent labels it would distribute as well. But isn't it true that EMI negotiates the prices and terms for the independent labels it distributes with the digital services such as Apple i-Tunes and others? And EMI also often negotiates on behalf of independent labels for distribution of physical CDs as well? If this is the case, shouldn't these independent labels be included in your market share?

EMI Label Services provides distribution services to independent labels whose sales comprise less than 1% of recorded music in North America. Each distribution agreement between EMI and an independent label is individually negotiated and the terms of those agreements vary widely. Some independent labels contract with EMI Label Services only for digital download distribution, others solely for physical distribution, and some for both. In particular, independents are more likely to retain digital distribution rights and contract with EMI Label Services solely for physical distribution. Further, final pricing authority for both digital and physical distribution remains with the independent record label, not with EMI. Independent labels not only control pricing of their recordings, they also own the masters of their recordings, which allows them to move their entire catalog to a new distribution company when the term of the contract ends.

More importantly, share of recorded music is not relevant to any company's ability to succeed in recorded music. Each company's share of recorded music is merely an indication of how successful the company has been in helping its artists record, promote, and sell their music to consumers. Similarly, pricing, promotion, and other decisions taken by retailers with respect to an album or track are based on consumer demand for that album or track, not on the share of music that its distributor holds at any point in time.

5. While new technologies are obviously very important in the music marketplace, about half of the music industry's revenues today still come from the sale of physical CDs, most in chain stores like Wal-Mart or Target or via Internet web sites such as Amazon. Does reducing the number of major record companies from 4 to 3 carry the risk of higher prices for consumers when they buy physical CDs?
Best Buy, Wal-Mart and Target jointly constitute over 60% of EMI’s physical retailer sales. Over the past ten years, each of these retailers have shrunk the retail space allocated to music by more than 50% and have cut the number of SKU’s carried by a similar number. For these retailers, music is not central to their success. Nevertheless, these stores are central to record companies and the careers of their artists. For EMI’s top three retail customers in the US, music represents less than half of one percent of their combined domestic turnover, so it is not hard to understand that it is retailers—not the record companies—that control the dynamic of the relationship. There is no risk that, after acquiring EMI, UMG could increase prices to Wal-Mart, Target, Amazon, or any other retailers.

6. We have heard concerns expressed about the major record companies’ use of “most favored nations” (MFN) clauses. Has EMI used MFN clauses, and, if so, why does it do so, and are there instances in which digital music services were required to pay higher royalties to EMI than those originally negotiated as a result of an MFN clause.

EMI sometimes uses MFN (Most Favored Nation) clauses in its agreements with digital music services. These clauses allow us to partner with digital companies whose business and technology propositions are untested and uncertain. Rather than wait to authorize a new service until after it has launched or authorize it for a very short period of time, MFNs allow us to manage the risk that the service will be more profitable than anticipated and able to pay recorded music companies higher rates from a larger than anticipated revenue pool.

I am not aware of any instance in which a digital music service was required to pay more to EMI than originally negotiated as a result of an MFN contract.

7. Are there any conditions you are willing to accept on the merger to obtain approval of the deal?

As the target of the acquisition (i.e., neither the current or future owner), EMI has no role in considering such conditions.

8. At the hearing, you requested to clarify the record regarding points made by Ms. Sohn. You stated that, in response to Ms. Sohn’s allegations that the record companies were found guilty of price fixing, that “Ms. Sohn has misstated the history.” Please describe how you believe Ms. Sohn has done so, or make any corrections to the record that you believe are necessary.

The FTC matter to which Ms. Sohn apparently referred was a civil antitrust investigation in 1999-2000 in which the facts and law were strongly disputed, in which no parties were “found guilty,” and in which no record company admitted to any liability in agreeing to a negotiated resolution. In fact, legal commentators have observed that, following the Supreme Court’s Leegin decision, the complained-of Minimum Advertised Price vertical restraint likely would be lawful and may, indeed, be viewed as pro-competitive.
Questions for Mr. Grainge:

1. Distribution Channels – Some observers have suggested that because of the many distribution platforms that exist in today’s digital age, gains in market share in the music industry may not necessarily lead to the same anti-competitive concerns they did in the past.

Mr. Grainge, please explain why these distribution platforms will keep large record labels in check?

   My world is fiercely competitive. The barriers to entry in the music industry have never been lower. Through technology and social networks, artists can market and distribute their own music. A new song can go from a YouTube clip to a worldwide sensation in 8 weeks. Google is selling music straight to consumers. The consumers are in control.

   Accordingly, we must distribute our music widely, providing music to consumers when and how they want it and on the devices they want. We have every incentive to license our music to every viable service in a world where there is an alternative for the artist to sell directly to consumers or worse, for consumers to listen to and acquire pirated music for free. We must distribute widely in order to survive.

2. Future of the Music Industry - One of the most important and interesting dynamics in evaluating the merits of this merger is the evolving nature of the music industry. We know the history of the industry, and we know the landscape of the industry today, but where do you think the future of the music industry will lie? How does your answer to that question impact our analysis of this merger?

   If the last decade has taught us anything, it’s that we cannot predict the future. In our industry, change is rapid and constant. We are in a world of the unknown. The music industry has been decimated by model shattering change and, looking forward, no one can predict what will come next. In such a world, we can only do what we do best: find and help artists, and then work to get their music to as many fans as possible how and where they want it. And so we are licensing and experimenting as broadly as possible and continuing to invest in new music.

   Universal’s pending acquisition of EMI’s recorded music business provides us an opportunity to bring back to EMI and its artists and fans stability and certainty as well as the strong expertise and skills we have in music development. We look forward to reinvigorating EMI and producing more creative, diverse music — music that we are committed to distributing broadly to consumers. As we confront an ever-changing landscape, our courageous investment in music at EMI will make the industry a better place for artists and fans.
Senator Committee on the Judiciary
Subcommittee on Antitrust, Competition Policy and Consumer Rights
Hearing on “The Universal Music Group/EMI Merger and the Future of Online Music”
Questions for the Record from Senator Herb Kohl

Questions for Mr. Grainge:

1. Universal Music has argued that we should not worry about its purchase of EMI – even though this will result in only three major record companies remaining – because the record companies have little power over price. You contend that pricing power is in the hands of online companies like Apple i-Tunes, or large chains like Wal-Mart, and that you cannot raise prices because you compete with free pirated music. You also argue that EMI is not competitively significant because it has few top artists under contract. Please then explain to us – why did Universal pay $1.9 billion dollars for EMI? You must see some competitive advantage in acquiring EMI – what is it?

With Universal Music’s pending acquisition of EMI’s recorded music business, we have the opportunity to return the ownership of EMI to the music industry and to provide a safe, long-term home for the business. It is a historic acquisition for Universal which will ensure the preservation of EMI, its artists, and their music. Universal is committed to preserving EMI’s cultural heritage and artistic diversity and will also invest in its artists to grow the company. Under Universal’s ownership, EMI will be able to make the most of the many new and exciting opportunities in the current marketplace, providing a better service to its artists, songwriters and business partners, while offering fans even more choice.

Universal’s pending $1.9 billion acquisition of EMI is a courageous investment in the future of music at a time when many have written off the music industry. With respect to price, I would note that Universal’s acquisition was priced at a cheaper multiple than Access Industries’ purchase of Warner earlier last year. More importantly, we view this as a “once in a lifetime” opportunity to buy the equivalent of a Picasso in terms of EMI’s deep, rich catalog at a very attractive price. EMI’s labels are an excellent fit for Universal, both culturally and creatively, but EMI needs stability and leadership committed to the long term in order to move forward. The range of “standalone” record labels within EMI (such as Parlophone and Capitol) will be retained, preserving and promoting a wide diversity of cultural music tastes and styles. Universal Music will also retain and promote EMI’s iconic Abbey Road studios. EMI is home to extraordinary musical history and iconic groups, with a catalog that includes The Beatles, Frank Sinatra, Charles Aznavour, the Beach Boys, and Coldplay. In particular, EMI will supplement Universal’s capabilities in country music, Christian genres, and gospel music, just as Universal’s resources will reinvigorate EMI.

At Universal, we value artists and the creation of music. We value the artists on EMI’s roster and hope to use our expertise and our resources to help them succeed. Our value system is good, and we want to bring that to EMI. If we are successful in what we hope to achieve, there will be more genres, more services, and more music for consumers to enjoy.
2. One key issue is for this merger we discussed at the hearing is whether the merger will make it much more difficult for new online distributors to enter the market. You contend it will not, and your written testimony stated that “it is in Universal’s interest to engage with the broad range of new distribution channels available to consumers.” But will your incentive change if you acquire EMI? In November 2011, shortly after this acquisition was announced, the Wall Street Journal reported that your parent Vivendi’s CEO, Jean-Claude Levy, had said that as a result of the EMI deal, Universal Music would gain bargaining power with digital distributions. He stated “we hope that in the future we will be less dependent on a certain number of digital platforms which have damaged our position.” Isn’t Mr. Levy acknowledging what your critics argue - that when you are combined with EMI you will have such a big share of the music business that you can effectively become the gatekeeper and block new digital services that you believe will harm Universal’s business model?

Universal embraces digital distribution, as we must. With respect to new, start-up services hoping to succeed with a new business model, we license to every viable, legal service. We invest in new entrepreneurs and new ideas, hoping that they have hit on the next big thing. Services aren’t necessarily viable when they come to us -- but their ideas may be. We want the widest possible legal availability for our music. That’s how we generate revenue and how our artists succeed -- and that is how EMI’s artists will succeed as a part of Universal with the pending acquisition. Our only route to success is to deliver our music to as many viable, legal digital platforms and in as many different ways as possible.

Over the past decade, Universal has invested approximately $500M in a variety of digital platforms. This investment demonstrates our commitment to engaging with every legitimate distribution service. We are completely agnostic about which devices or technology consumers use to hear our music (as long as it is legal). Our duty and our goal is to deliver that music to as many different consumers in as many different genres and in as many different markets as we can. It is the only way in which there is any sustainable business model for music.

Distribution today is much more consumer driven than it was only a few years ago. Consumers can choose to receive or access music from a variety of digital services and on a variety of digital platforms. It is in our interest to ensure that our recordings are included in those services and on those platforms, not only from the standpoint of commercial opportunity. These services are the new neighborhood record store, only they are often not just in the business of selling music. With respect to established companies such as Apple and Google, these companies make a very small percentage of their revenue from music and have the financial resources that would allow them to buy and sell the music industry with the strength of their financial position. For example, in addition to its sales of devices such as iPods, iPhones, and iPads, Apple also has its iTunes store, which sells movies, television shows, audio books, Podcasts, applications and related services – in addition to music. If Apple stops selling our music, we go out of business. Apple does not. We depend on digital services to reach our consumers.
3. In recent years, we've heard that the music industry is in bad economic health and some assert this as a reason that this merger should be allowed. Yet RIAA statistics show that the music industry shipped over 1.8 billion units of both albums and singles last year, nearly double the units shipped a decade earlier. Music sales increased for the first time since 2011, with digital single sales up 13%. A report just issued by PriceWaterhouseCoopers predicts increasing digital music sales will cause the U.S. recorded music market to grow by 17.9% over the next five years. Universal made a $671 million dollar profit on revenues of over $5.5 billion dollars last year, a healthy 12% return. In light of these statistics, do you think the music industry is in such poor health that it needs further consolidation to survive? Are you asserting the poor economic health of the music industry as a reason for this merger? If so, don't those industry statistics, and Universal's own strong profitability, contradict the view that the industry is in poor shape?

In the last ten years, I have seen more changes on an annual basis than I saw in each of the decades that preceded it. Our industry has been decimated — halved — but even so, we are not asserting the poor economic health of the industry as the reason for this proposed acquisition. Further, I must respectfully note that your financial performance figures for Universal are misleading, in that they reflect Universal's worldwide performance (versus U.S.) for not just recorded music but also including publishing and merchandise as well. I must also respectfully disagree with your conclusion as to the RIAA statistics. In a decade that has seen single tracks come to dominate over sales of whole albums, focusing solely on a purported doubling of "unit sales" over that period is questionable, to say the least. The industry in the United States sold over 930 million albums in 2001, versus only 351 million physical and digital albums in 2011. Even adding in the huge growth in the sales of digital singles doesn't even begin to make up that difference. By nearly any measure, the recorded music market has declined by over 40% over this period, not "doubled" as the question presumes. And although the total market increased slightly in 2011 in album equivalent unit terms for the first time since 2004 (up 3%), it decreased in wholesale and retail dollar terms (down 1%). But we hope that we have reached a turning point where the Internet is an opportunity rather than a threat. Although there has unfortunately been a renewed decline of CD-album sales in the first half of 2012, we know that this demonstrates the unpredictable nature and uncertainty of the music business. Nonetheless, we are hopeful that, by embracing digital distribution, the music industry will have a bright future.

With Universal's pending acquisition of EMI's recorded music business, we have a moment where we can be a part of that bright future. My goal is to get music to as many people as we can. That is why we have stepped up to make a courageous investment in talented artists and to provide the resources, professional experience, and expertise so that those artists capture an audience and fan base. We look forward to welcoming EMI's artists to Universal, supporting their careers, and providing more creative, diverse music for consumers.

4. (a) The merger's critics argue that it will leave Universal with a 40% market share, and the three large record companies controlling 90% of the market. Universal has argued that this market share computation is incorrect because it includes not just the

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1 Ed Christman, SoundScan Mid-Year Report: Unit Sales Up 4 Percent, Although Album Sales Dropped 3.2 Percent, Billboard.biz (July 5, 2012).
music labels it owns, but independent labels it distributes. But isn’t it true that Universal negotiates the prices and terms for the independent labels it distributes with the digital services such as Apple i-Tunes and others? And Universal also often negotiates on behalf of independent labels for distribution of physical CDs as well? If this is the case, shouldn’t these independent labels be included in your market share?

Universal generally does not negotiate the price or terms of sale on behalf of the independent labels or “Indies” for which it handles distribution (distributed labels). Similarly, Universal has no involvement at all in the creation, recording, marketing, or scheduling of the records produced by those independent, distributed labels. Because Universal does not make those decisions for distributed labels or own or control the repertoire, distributed labels should not be included in Universal’s market share. In fact, Universal competes vigorously with the Indies which, according to A2IM, the Indie trade association, represent over 30% of the market in the US.2 Indeed, the global rights agency Merlin, which represents independent music rights, refers to itself as the “the virtual fifth major.”3

More specifically, for distributed labels, Universal does not negotiate the pricing or terms of sale with physical or digital download wholesale customers. Rather, the distributed labels will select (or change) wholesale price categories for their products and then inform Universal as to their selection. Similarly, distributed labels will decide whether to offer any discounts or special payment terms to physical or digital wholesale customers on their products, and then inform Universal as to their decision. Universal will then pass on that information to the applicable wholesale customer. Distributed labels will also negotiate directly with physical or digital wholesale customers to secure promotional placement in a wholesale customer’s storefront. Distributed labels similarly control all marketing decisions and the release date of their products. Universal may act as a facilitator between the wholesale customer and the independent label by communicating and/or negotiating terms for a product, but the ultimate determination whether to offer certain pricing terms or accept the pricing terms requested by a wholesale customer always rests with the distributed label and not with Universal. Moreover, some artists object to putting their music on streaming services, and their labels must abide by their choice.

Although the distributed labels generally have received the same pricing terms with streaming and subscription services that Universal negotiated for its owned labels, distributed labels control other aspects of the distribution of their music to streaming services. Further, for context, only about 3% of Universal’s revenues are derived from audio streaming and subscription services. The vast majority of Universal’s revenues are attributable to sales of physical product and digital downloads where, quite simply, Universal does not make the competitive decisions for distributed labels.

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3 Merlin’s mission is “to ensure its members have effective access to new and emerging revenue streams and that their rights are appropriately valued and protected.” It holds itself out as “the most efficient means for digital music services to license repertoire from the largest and most compelling basket of independent rights in the world.” Merlin, “Welcome to Merlin,” available at http://www.merlinnetwork.org/home/.
(b) In a November 2011 Investor Meeting presentation, you stated that Universal’s market share was 26.5% in 2010. Did Universal Music include in that market share calculation the independent labels it distributes? If so, why would you argue in the context of this merger not to include the independent labels you distribute in your market share calculations?

The November 2011 Investor Meeting referred to above cited a market share calculation for recorded music compiled by the International Federation of the Phonographic Industry (IFPI). IFPI is a trade association that compiles statistics on the European and international markets. IFPI includes distributed labels in its market share calculations. Although this measure has been the subject of some scrutiny and disagreement within the industry, IFPI determines its own standards.

For purposes of this acquisition and evaluating competition issues in the U.S., we believe the most accurate calculation of market share is by unit sales of owned repertoire, as measured by SoundScan -- the official method of tracking sales of music and music video products in the United States. As noted in the answer to Question 4(a) above, because Universal does not negotiate on behalf of the independent labels it distributes as to prices and terms for the sale of physical product and digital downloads, distributed labels should not be included in Universal’s market share.

5. While new technologies are obviously very important in the music marketplace, about half of the music industry’s revenues today still come from the sale of physical CDs, most in chain stores like Wal-Mart or Target or via Internet web sites such as Amazon. Does reducing the number of major record companies from 4 to 3 carry the risk of higher prices for consumers when they buy physical CDs?

This is not a 4 to 3 merger. To suggest that simply ignores the reality of today’s marketplace and the large number of independent labels with which we compete vigorously every day. In fact, Merlin markets itself as “the virtual fifth major.” In any event, Universal’s pending acquisition of EMI’s recorded music business does not carry the risk of higher prices for consumers when they buy physical CDs. Neither Universal nor EMI set the prices for physical CDs -- big box retailers set prices for the music on their shelves. The idea that we could dictate terms to multinational companies like Walmart is not the world I live in. If music is too expensive and doesn’t sell well, retailers will not stock it, artists will lose sales, and I will lose my job. This is a chart-driven industry. A retailer will stock what he thinks he can sell at the best price he thinks he can sell that product to consumers. There has been an enormous reduction in the shelf space dedicated to music in physical retail outlets as well as in the number of retail outlets that are selling physical music. Both Walmart and Best Buy have recently reduced their music shelf space by significant proportion. And just like Apple on the digital side of sales, big box retailers would not go out of business if they stopped selling our music. But we would.

6. We have heard concerns expressed about the major record companies’ use of “most favored nations” (MFN) clauses. Has Universal Music used MFN clauses, and, if so, why does it do so. And, are there instances in which digital music services were required to pay
higher royalties to Universal Music than those originally negotiated as a result of an MFN clause.

Some of Universal’s agreements with digital music services have included so-called “most favored nations” clauses. It is our understanding that the other major labels also use “most favored nations” clauses. The reason is simple. In an industry where dramatic change is constant, and technology is always providing new and different ways for people to enjoy music, it is impossible for us or for anyone to predict whether and how a new distribution model will work out. No one can predict whether an innovative new service will appeal to consumers and whether untested business models will prove viable. Under these circumstances, “most favored nations” clauses are an important way for us (and others in the industry) to be able to enter into contracts with innovative digital distributors in the face of this uncertainty. In some instances, these “most favored nations” clauses have been triggered, although many of our contractual agreements have provisions to protect the confidentiality of the terms in those agreements.

7. During the course of the hearing, you or Mr. Faxon indicated that:

- Universal Music does not intend to cut EMI’s roster after the merger, and indeed plans to possibly expand it.
- Universal Music could not raise prices because of power buyers (e.g. Apple/iTunes, chain stores such as Wal-Mart) and piracy.
- Record labels are not critical to commercial success by performers and artists and that, in effect, anyone can market music successfully to the public.

Further, Mr. Faxon wrote in his written testimony:

"So, record companies can’t control consumer pricing, don’t control access to consumers, can’t exert control over promotional platforms or the myriad of music discovery tools that fans use today, and they’re having to compete with the vastly increased number of alternative paths to market for budding or even established artists."

Assuming these assertions to be true as you and Mr. Faxon claim, please identify and describe for us what efficiencies Universal Music hopes to gain from merging with EMI and what valuation Universal has put on those efficiencies?

We are purchasing EMI to restore it to the historically significant position it held in our culture decades ago. That means investing in more artists and musicians and producers and songwriters and other music professionals that can create sounds that captivate audiences.

As part of our valuation of EMI and the development of our offer to Citibank, we estimated the synergies that could be achieved as part of this acquisition. As discussed during Vivendi’s analyst briefing conducted following the announcement of the deal (on November 11, 2011), Universal expects to achieve significant synergies from the combination reaching more than £100M annually, particularly through overhead efficiencies. In particular, we expect that significant synergies and efficiencies can be achieved in the back office and support functions,
and the savings from those synergies and efficiencies would be used to finance our increased investment in the creation of music.

As I testified, Universal intends to invest in EMI’s recorded music business. By providing additional resources for artists and the marketing and promotion of EMI’s catalog, Universal will reinvigorate EMI. This investment shows great courage and a firm belief in an industry that has been decimated, and we are excited about investing in the future of music at EMI.

8. In your written testimony for the hearing, you stated:

"[T]echnological advances mean that neither a ‘major’ label deal nor an ‘Indie’ label deal are essential for an artist. As David Pogue, the New York Times technology column, wrote in the May 9, 2012 New York Times, ‘In the online world, you can take your music straight to the public. No more gatekeepers, record executives or rejection letters. If you’re any good, you’ll soon win your fame and fortune — or at least sky-high view counts.’ “

In his written testimony, Irving Azoff said: “Approximately 40% of Front Line artists aren’t even on labels. I have no doubt that labels add value, but you just don’t have to have one in a world where artists can deliver an album direct to fans themselves. It’s a little like hiring an interior decorator to re-do your house.”

Roger Faxon wrote: “[T]hat’s the music that matters, not the source of that music.”

Do you agree with the statements of Mr. Azoff and Mr. Faxon? Assuming you do, and in light of your own testimony quoted above, please tell us what services or economic value Universal Music offers to artists who sign to it and what you believe persuades an artist to sign with the company.

This is a fiercely competitive business. It is also fundamentally a “people” business, and we have the very best creative people. We are service providers, and artists have options about who they want to provide those services. We know that an artist can go elsewhere and that artists have choices that they did not have 3 or 5 or certainly 10 years ago. We have to work harder and harder to sign them and to keep them. Artists can always choose to work with another major label. They can sell directly to consumers. They can choose to work with one of the many successful Indie labels.

But they can also prefer to work with Universal, and with all due respect, we believe we are the best at what we do. The reason that an artist signs with a label is, first and foremost, a connection with the creative executive and a shared vision for the creative direction for the project. I worked with one artist who told me that he preferred working with a label so that many people were working to develop his music. At Universal, our track record is very, very good, and we have been fortunate to have an exceptional creative staff in the A&R and marketing areas. We will be there creatively to help our artists every step of the way. We also help our artists with their marketing, licensing, and distribution. That is what we bring – talented executives and a shared creative vision.
Universal looks forward to working with EMI's artists and to supporting their artistic development by providing resources and expertise to promote their success. Universal will provide those artists with a stable home for their creative growth. With our experience and passion for music, we will help all our artists make the best music possible, and then we will get that music to their fans in as many ways as possible.

9. Are there any conditions you are willing to accept on the merger to obtain approval of the deal?

We do not believe there are antitrust issues which warrant any conditions being placed on the deal.
Questions for Mr. Grainge:

1. In many cases, mergers benefit the market and consumers by creating efficiencies that reduce costs or enhance productivity.
   - What efficiencies will this merger create and how will it benefit the music industry and consumers?

   We are purchasing EMI to restore it to the historically significant position it held in our culture decades ago. That means investing in more artists and musicians and producers and songwriters and other music professionals that can create sounds that captivate audiences.

   As part of our valuation of EMI and the development of our offer to Citibank, we estimated the synergies that could be achieved as part of this acquisition. As discussed during Vivendi’s analyst briefing conducted following the announcement of the deal (on November 11, 2011), Universal expects to achieve significant synergies from the combination reaching more than £100M annually, particularly through overhead efficiencies. In particular, we expect that significant synergies and efficiencies can be achieved in the back office and support functions, and the savings from these synergies and efficiencies would be used to finance our increased investment in the creation of music.

   By providing additional resources for artists and the marketing and promotion of EMI’s catalog, Universal will reinvigorate EMI’s creative business. We are excited about developing new artists. This investment shows great courage and a firm belief in an industry that has been decimated over the course of a decade and cannot rebuild overnight. We are committed to the long term success of the business and culture of music, and we are excited about investing in the future of music at EMI. Universal’s acquisition will enhance creative investment in the company and further broaden support for digital services. This will provide more opportunities for artists and more music and choice for consumers than ever before. In this dynamic industry, where change is constant, we have a chance to be a part of the future of music. We have a chance to support the creation of more music for consumers.

2. Critics of the merger suggest that a combined Universal-EMI will have the ability and incentive to prevent the success of new digital distribution models by refusing to license its catalog.
   - What are your incentives with respect to participating in digital distribution?
     - How would the merger change your incentives?

   I see the future as continuing to be as challenging and as extremely competitive as the past has been. In this competitive market, our only route to success is to deliver our music to
many new, innovative, commercially viable digital platforms and in as many different ways as possible. We license nascent digital services before they become iTunes. I have to be totally open-minded today, and we work now with any legitimate service, as long as they pay for music. With this acquisition, we will continue to invest in as many genres and markets as we are able to, and we will continue to support the growth and development of legitimate digital distribution platforms. With EMI, we will continue to do everything we can to sell music and to create opportunities to connect our music with consumers. If we don’t get music to consumers how and when they want it, they will get that music for free and the moment will be lost. That is our incentive today, and our incentives will not change with the acquisition of EMI.

- Is Universal-EMI’s catalog already a “must-have” for new distributors to succeed?
  - How would this merger change that dynamic?

Like the other major labels, Universal already has countless “must have” songs – whether it is the Motown collection or Elton John or U2. And we embrace, as we must, a market strategy of wide distribution. We will have the same strong incentives to distribute EMI’s catalog. Our acquisition of EMI’s recorded music business will not change this dynamic.

No one knows what business models will succeed in 3 years or 5 years or 10 years. We are licensing and experimenting as broadly as possible because we need our music to reach as many consumers as possible. Most consumers don’t know that Rihanna is a Universal artist, but they know that they want their music service to have Rihanna songs. We simply must replenish our roster with new talent all the time because it is new talent that brings in new audiences which are the lifeblood of rebuilding our industry and attracting consumers to digital services. We have a strong track record of licensing our music broadly. We sign hundreds of new distribution deals every year, and we are willing to talk with any viable new service with a credible business plan. We owe that to our artists, we owe that to their fans, and we owe that to our shareholders – it is our recipe for success.

3. Currently, new online services have the option to approach any of the four majors to begin contract negotiations, and an agreement with any one label could begin a sequential contracting process in which all the labels eventually agree to license.

- Do you believe new services could successfully begin the sequential contracting process by approaching labels other than Universal after the merger, or would Universal become the obligatory first stop?

Respectfully, I must disagree with the premise of your question, which assumes that contract negotiations are always a sequential process. There is no pattern of sequential negotiating. Negotiations often begin simultaneously.

But under all circumstances, Universal is absolutely committed to distributing our music widely on digital services. Consumers control the market, and our artists’ music must be available on the services that consumers want.
Of course new legal, viable services will be able to approach labels other than Universal first. Universal already has “must have” music. Yet, digital services often reach agreements with other labels first. Beyond Oblivion, eMusic, and Slacker all entered into deals with Sony first. Lala and YouTube entered into deals with Warner first. And Amazon MP3 and Google MP3 entered into deals with EMI first -- even though EMI has the smallest market share of the major labels.

Digital distributors will have just as much incentive and opportunity to seek “must have” music from Sony and Warner and Merlin after Universal’s acquisition of EMI, and thus just as much incentive to approach those labels first. Further, no matter which label is approached first, negotiations are often conducted simultaneously. Universal looks forward to participating with its music, and the music produced by artists at a reinvigorated EMI, in viable new digital services.

4. Defining the market is a primary step in evaluating the effects of a merger. Some suggest that the market for recorded music should be defined by distribution, while others would define the market by ownership. Some hold that album sales are the important indicator of market share, while others claim that total revenues is the more relevant indicator.

- How would you propose that regulators define the relevant market?
  - By distribution or ownership? By album sales or total revenues?

For purposes of antitrust analysis, Universal proposes that its market share be calculated by unit sales of owned repertoire using SoundScan data, which is the industry standard data source in the U.S. Because Universal generally does not negotiate on behalf of the independent labels that it distributes, does not set the prices for their music, and does not own or control their repertoire, distributed labels should not be included in Universal’s market share.

5. Piracy has greatly impacted the music industry for the last fifteen years. Despite efforts by many sectors to curtail the efforts of online thieves, piracy continues to provide easy access to illegitimate, free music.

- What effect does the prevalence of piracy have on pricing in today’s music market?

Unfortunately, piracy has become a fact of life in our industry, and it puts significant pressure on pricing. In a digital world, a plethora of unauthorized websites and music services offer perfect copies of our recordings -- sometimes our property is even available illegally before

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1. Glenn Peoples, Beyond Oblivion: The Rise in Music Service Signs Licensing Deal With Sony Music, Others Coming, Billboard.biz (Aug. 24, 2011); Nate Andersen, Springsteen, Dylan come to eMusic as labels open up, Ars technica (June 1, 2009); Elliot Van Buskirk, Slacker Music Service Signs Deals with All Major Labels, Thousands of Indies, Wired (Sept. 29, 2007).


3. Bruce Houghton, Amazon Announces MP3 Download Store With EMI Catalog and 12.000 Labels, Hypebot.com (May 16, 2007); Peter Kafka, Google Music’s New Service Set to Launch, Without All the Music, AllThingsD (Nov. 11, 2011).
it is available in the legitimate marketplace. Consumers have the option of acquiring perfect substitutes for our property for free and have done so billions of times. Our goal is to authorize a large number of competing services that give consumers what they want, how they want it, at attractive price points, so that consumers have an attractive, legal alternative. By supporting new, innovative, commercially viable services, we can find ways to create revenue for our artists and shareholders. I’m really proud of our achievements in this regard. We’ve been at the forefront of the digital revolution.

6. In 2009, Apple was able to effect a 30 percent increase in the price of a single without a marked drop in sales.
   * Does this suggest that the downward pressure piracy exerts on prices is insignificant?

   When iTunes was launched, 99 cents was the launch price for all singles. Apple set that introductory price, and it came out of nowhere. 99 cents was never a market price.

   In the nine years since the launch of iTunes, there has only been one price change for music sold via that service. I cannot think of a single other valuable good or service that has realized a price change only once in nine years. This price change was more than reasonable, particularly since that change was part of a change to variable pricing – meaning that some music went up in price while other music went down in price and some remained the same. Specifically, in 2009, Apple introduced variable track pricing – allowing single track downloads to be sold at three price points – 69 cents, 99 cents and $1.29. That change, however, was NOT a 30% increase in the price of a single. That change allowed different price points to more closely match price with demand, and it was accompanied by a significant increase in quality. At the time of the implementation of variable track pricing, the record labels agreed to deliver the recordings without digital rights management (DRM), meaning that whatever song the customer bought could be used and shared with multiple platforms and devices. Now the consumer owned the song. And we also increased sound quality – namely, the “bit rate” of the tracks. So, while some songs cost the same, some more, and some less, the consumer value and quality improved.

   Furthermore, the iTunes pricing changes coincided with a huge uptick in device sales and technology -- the iPhone, tablets -- and I think that the statistics about sales at that time also resulted from the increase in demand because of the new technology. The fact of the matter is that piracy exerts a significant downward pressure on price.

7. At the hearing, Mr. Bronfman testified that of the licenses Universal has granted to digital distribution platforms “at least fifty of those licenses are exclusionary licenses where only Universal music is licensed, and other music companies will be invited in sometime later.”
   * Is this accurate?
   * How many exclusionary licenses to digital music services have you granted?
   * What is the rationale for these exclusionary licenses?
Mr. Bronfman's testimony about Universal's licenses with digital distribution platforms is not accurate. He was simply mistaken. When Mr. Bronfman refers to "at least fifty . . . exclusionary licenses," he appears to be referring to a statement by Robb Wells, Universal's President for Global Digital Business, about Universal's strategic marketing partnerships (SMPs) -- NOT our licenses to digital music services. 4 In particular, Mr. Wells was referring to business development deals with other (non-music) companies that use music promotions as a part of their consumer marketing strategies. For example, one typical SMP involved an agreement with a beverage company that was to create Universal artist-inspired bottles and to distribute codes to consumers who bought the bottles to allow them to download UMG sound recordings. Another example involved an agreement with a cell phone company that allowed its customers to download certain UMG ringtones and sound recordings as part of the overall cost of a phone service plan. As in those examples, SMPs may be exclusive in that they are necessarily limited to Universal's music. But those strategic marketing partnerships are just that - marketing partnerships; they are NOT the terms on which we license our music to digital music services. As I testified at the hearing, when it comes to digital music services such as Rhapsody, MOG, Rdio, Deezer, Spotify, and other such services, Universal's licenses are not exclusionary but instead we license our content broadly and on a non-exclusive basis to digital music services that bring content to consumers.

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4 Rob Wells, Interview, ThisWeekInMusic, available at http://www.youtube.com/watch?v=LbAT9Ap9Evs (minutes 47-59:30) (discussing "strategic marketing partnerships").
ANSWERS OF MARTIN MILLS (BEGGARS GROUP) TO

Senator Kohl’s Follow-Up Questions for the Record for Hearing on

“The Universal Music Group/EMI Merger and the Future of Online Music”

Before responding to Senator Kohl’s questions I would direct attention to my written statements and oral statement presented to the Senate Antitrust Subcommittee and incorporate those statements into my responses to Senator Kohl’s questions.

Question 1(a): One of the main arguments against the merger by its critics is the claim that, given Universal Music’s post-merger market share, it will have the power to prevent the launch of any new digital distribution service, as no service could launch without access to Universal’s catalogue of music. But, even if Universal could do that, why would it want to? Doesn’t Universal have an interest in seeing its music distributed as widely as possible? Does Universal have the means and incentive to block the launch of new online music services?

Answer: Universal Music does indeed have an interest in having its catalogue of music widely distributed – but only on its terms. It is my belief that because of its “must have” artists and catalogue (and very much more so as a result of the EMI transaction) it has the capability to make or break a new distribution service. It can and will prevent a successful launch by refusing to contract or by requiring such onerous contract terms that the new service cannot afford on competitive terms the repertoire from independent labels that the kind of listeners who are adventurous enough to try new services would like to be able to access. I believe that Universal effectively blocked the success of digital start-ups Beyond Oblivion and Nokia’s “Comes with Music” by imposing onerous contract terms.

It is my belief that Universal would have the incentive to block the launch of a new innovative service or attempt to modify it for a number of reasons. First, Universal might not like the service’s terms to labels or consumers. Second, Universal will likely object if the new service gives independent labels an opportunity to have a fair airing of their artists’ work. Third, the new service’s model might not comply with Universal’s demands to replicate their domination of the physical market in the new service’s site.

Question 1(b): Assuming Universal in fact could block the launch of new online music services, what would that mean for your ability to distribute your label’s music?

Answer: It is my belief that if Universal Music blocked the launch of a new music service it would limit the ability of Beggars Group, and other independent labels, to distribute their music in two ways. First, it would eliminate a possible outlet for their music. Second, it would tend to intimidate existing music services and cause them to more readily agree to Universal’s otherwise onerous contract terms.

It is my belief that the Statement of Objections recently issued by the European Commission confirms the onerous nature of Universal’s terms to digital services, and its increased ability post-merger to impose worse terms on digital and physical customers.
Ultimately Universal will have, post-merger, the incentive and ability to obtain over-exposure of its artists in terms of access to digital and physical customers through radio and television. It will also have an increased ability and incentive to sign more popular artists on more favourable terms. All of these factors will at least partially foreclose competitors and also increase Universal’s power in digital and physical arenas. The Universal Music/EMI transaction will produce distinct anti-competitive effects, including price increases and stifling innovation in digital services.

Question 2: What’s your view of the health of the music industry today? Do you agree with the view that the music industry is in such poor health that consolidation is necessary? Why or why not?

Answer: After a period of decline in the overall music market, I believe that the financial health of the industry has bottomed out and that some level of growth has begun. I also believe that a large part of the decline has been due to unbundling – the ability of consumers to buy a single track rather than an album. This has been a seismic and irreversible process, and it is now complete. This transition from decline to stasis to growth mirrors the transition from the dominance of the physical music market to the emergence of the digital market.

Question 3(a): In your written testimony you claim that this merger will harm independent labels like the one you own because it will impede their ability to compete with the major labels to promote new and diverse artists. However, one of the artists signed to your label, is Adele, one of the most successful and popular singers to emerge in years. Just a few years ago, she was completely unknown. Doesn’t her success on your label show that independent labels can thrive today? Would the merger do anything to change this?

Answer: As indicated in my statements, Adele has a unique ability to touch listeners. She is a phenomenon, an exceptional talent that comes along only every 15 to 20 years. If we want to look at the overall ability of independents to compete, we look at the second or the third best selling album of the year, or the best selling album of any other year, or how many independent albums there are in the Top 10 or Top 100. Anyone working in music knows that no conclusions can be drawn from Adele about the ability of other independent artists to replicate her success. In our case, in the U.S. it provides an excellent example of why the UMG/EMI transaction should be blocked because even Adele needed Sony to release her music, due to Sony’s access to media.

I believe that the conclusions of the European Commission in its Statement of Objections, referred to above, also deal with the competitive potential of independent labels which reflects the reality of the market today in Europe and also in the U.S. and I would urge the Senate to try to obtain a copy of this important document.

Question 3(b): Some independent record labels appear not to agree with your view that this deal threatens independent labels. For example, in April, Scott Borchetta of Big Machine Records
told the Nashville Tennessean newspaper that he did not think this merger would harm independent labels because “if I continue to make great records by great artists, nobody can stop us.” Why do you think he sees things so differently from you?

Answer: I do not know Mr. Borchetta so I am unable to fully address his views regarding the UMG/EMI transaction, although I know he operates in the country music field, which may have specific characteristics. Although independents are by nature maverick, and will always have differing views, I can say that the vast majority of independent label executives and artists that I have talked with are of the view that the UMG/EMI transaction will seriously damage the digital music business by allowing the leading company in the industry to become 33% bigger, by allowing an innovative competitor to be eliminated and by creating a duopoly with Sony. The independent label associations in the U.S. and around the world support this view.

Question 4: Do you believe there are any conditions that the FTC should place on the Universal Music/EMI merger, should the agency decide to approve it, and, if so, what are they?

Answer: I do not believe that there are any conditions that the Federal Trade Commission could place on the UMG/EMI transaction that would cure the anticompetitive consequences that flow from the transaction.
ANSWERS OF MARTIN MILLS (BECCARDS GROUP) TO

Senator Lee’s Follow-Up Questions for the Record for Hearing on
“The Universal Music Group/EMI Merger and the Future of Online Music”

Before responding to Senator Lee’s questions I would direct attention to my written statements and oral statement presented to the Senate Antitrust Subcommittee and incorporate those statements into my responses to Senator Lee’s questions.

Question 1: Currently, many independent labels contract with major labels to perform distribution services. Compared to physical distribution, digital distribution is substantially easier for an indie to perform on its own.

- As digital sales increase and physical sales decline, will indie labels continue to contract with majors for distribution?
- How would a decrease in distribution contracts affect the breakdown of market shares?

Answer: It is my belief that “indie” labels and their artists will continue to contract with the Majors for distribution as digital sales increase and physical sales decline. The basis for my opinion is that the Majors largely control access to digital music services. Even previously independent digital distributors such as The Orchard and IODA are now controlled and at least partially owned by the Majors. While some larger “indie” labels can and do contract with digital music services, services don’t want to have too many customers to deal with, and the Majors, because of their “must have” artists and catalogues, directly and indirectly manipulate the music services to give their artists greater attention on the music services’ websites and in their playlists. What needs to be recalled is that the Majors successfully dominated distribution in the physical market and are now attempting to replicate that domination in the digital market. They are also increasingly insisting that labels license online rights as part of physical distribution. Even our artist Adele had to contract with Sony for distribution in the U.S., including digital rights.

The second question is confusing because in order to have a reduction in distribution contracts you would need to have a reduction in the number of distributors or in the number of artists seeking distribution. Assuming for purposes of this question that there has been an overall reduction in distribution contracts for whatever reason, such reduction is likely to result in higher market shares for the bigger players as more focus will be placed on fewer artists.

Ultimately Universal will increase its ability post-merger to impose worse terms on digital and physical customers, along with its incentive and ability to obtain over-exposure of its artists on radio and television, and its increased ability and incentive to sign more popular artists on more favourable terms. All of these factors will at least partially foreclose
competitors, and increase Universal's power in digital and physical. The Universal/EMI transaction will produce distinct anti-competitive effects, including price increases and stifling innovation in digital services.

Finally, I believe the conclusions of the Statement of Objections recently issued by the European Commission confirm the impact of the merger in digital and across the market and I would urge the Senate to obtain a copy of this important document.
Sen. Kohl's Follow-Up Questions for the Record for Hearing on
“The Universal Music Group/EMI Merger and the Future of Online Music”

For Gigi Sohn

1. We understand that one of your main arguments against the merger is that, given Universal's post-merger market share, it will have the power to prevent the launch of any new digital distribution service, as no service could launch without access to Universal's catalogue of music. But, even if Universal could do that, why would they want to? Doesn't Universal have an interest in seeing its music distributed as widely as possible? And are there examples of music services that Universal has prevented from launching in the last few years?

Incumbent major record labels like Universal Music Group (UMG) have the incentive to stifle new digital distribution platforms because those platforms begin to level the playing field among major labels, independent labels, and unsigned artists. As digital platforms increase artists' ability to build a sustainable career on an independent label or without a record label at all, major labels begin to lose their leverage over distribution platforms and over artists.

Digital platforms are more likely to license unknown or niche music because, unlike their physical space predecessors, they are not constrained by time limits (like radio) or space limits (like physical stores). As a result, the major record labels lose one of their main selling points to musicians—namely, that they have the connections and influence that a musician absolutely needs to get his or her music out in the marketplace. Thus, the dominant incumbent labels are particularly incentivized to stifle digital platforms that will decrease their influence as compared to smaller competing labels or unsigned acts.

With the advent of digital platforms, many of the services that set major record labels apart from their independent competitors are becoming irrelevant. A major label's ability to get the right consultant to convince a radio programmer to play a new release on the air is simply not as valuable in a world where more and more consumers use online radio services like iHeartRadio, Pandora, and Songza. Major labels' relationships with brick-and-mortar stores are not as useful when so many sales are made online, and services like CD Baby help independent artists promote and distribute their works. A major label's special connections to promote an album are less necessary now that an artist can build a fan base using social media or online advertisements. Finally, artists are increasingly willing to record their own songs using new technology rather than wait for a major label contract to release their first LP. Although these developments are obviously disruptive to the more traditional major labels, they are a welcome boon to independent labels and unsigned artists, who are for the first time enjoying a much more level playing field than the music business has ever seen.

However, if the combined UMG-EMI entity can undercut the success of a new digital music platform by withholding 41% of the market from that platform, it may be able to maintain its
market dominance through anticompetitive conduct rather than innovating and competing against new market entrants. If a digital platform never launches because it could not attract enough users with only little more than half of the most popular music, an independent label could never take advantage of that platform to promote its artists head-to-head against major label artists.

Universal’s argument that it can be trusted to embrace digital licensing because it is accountable to its current artists is without merit. Artists’ contracts with major labels do not allow the artist to simply leave for another label because the artist disapproves of the label’s business decisions. To the contrary, artists are often locked in to a major label contract for several albums, even though the label retains discretion to delay or refuse to release an album.

UMG’s own behavior confirms that major labels see a strong short-term interest in stifling or controlling the development of digital distribution services. For example, rather than offer a reasonable license, Universal sued the video site Veoh early in its creation for copyright infringement. Despite the fact that Veoh was lawful and was ultimately vindicated in court, the litigation bankrupted the company and hamstrung its potential. Last year Universal was the first of the major labels to sue the streaming music service Grooveshark, even though Grooveshark had reportedly sought a license from Universal well before the suit was filed and despite Grooveshark’s legal arguments that it did not need a license. Universal has not granted a U.S. license to music streaming service Deezer (despite its release or pending release in 200 countries), and had even sued Deezer in France after the company refused Universal’s demand that it limit its freemium tier to five consecutive songs. Luckily, the French courts agreed with Deezer, holding that Universal’s behavior was “an abuse of a dominant position.” Universal also refused to license to the digital music service Beyond Oblivion, which was founded in 2008 but filed for bankruptcy before it had even launched.

2. What’s your view of the health of the music industry today? Do you think the music industry is in such poor health that consolidation is necessary? Why or why not?

The music industry is in good health and income from digital sources is steadily growing, but the nascent digital marketplace is not immune from anticompetitive behavior from the dominant incumbent labels.

The most recent reports from the RIAA for 2011 show that total shipments of physical and digital units increased 0.2% from 2010 to 2011, in addition to a 17.2% increase in digital performance royalties and a 4.1% increase in synchronization royalties.1 Revenue for digital downloads totaled $2.6 billion in 2011—a 17% increase over 2010. Revenue from subscription music services grew 13% to $241 million as the number of subscribers increased from 1.5 million to 1.8 million. Record labels have responded to the growth in digital services by claiming a significantly higher percentage of revenue for each unit shipped even as costs decreased.2

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2 See Mark Cooper and Jodie Griffin, The Role Of Antitrust In Protecting Competition, Innovation And Consumers As The Digital Revolution Matures: The Case Against The Universal-Emi Merger And E-
But the fact that the advent of digital music services has bolstered the health of the recorded music business does not mean that digital distribution has made the recorded music business immune from anticompetitive behavior. As discussed above, the major record labels have a strong incentive to stifle or control the development of digital music services, and their exclusive control over the distribution of today’s most popular music enables them to prevent new services from launching or demand onerous terms from new services.

3. **While new technologies are obviously very important in the music marketplace, about half of the music industry’s revenues today still come from the sale of physical CDs, most in chain stores like Wal-Mart or Target or via Internet web sites such as Amazon. Does reducing the number of major record companies from 4 to 3 carry the risk of higher prices for consumers when they buy physical CDs? Why or why not?**

Under a straightforward horizontal market concentration analysis, this merger would lead to even more consolidation in the physical market than it would in the digital market and would dramatically reduce competition between the major labels. The market for physical albums and singles is already highly concentrated and has existed as a tight oligopoly for more than a decade.

The proposed merger’s impact on market concentration would be most dramatic in the market for physical albums, raising the HHI for the physical album market 1,147 points, from 2,340 to 3,487. Under the Merger Guidelines, this would raise the market concentration level from “moderately concentrated” to “highly concentrated” and would raise the HHI more than five times the level that is presumed likely to enhance market power.

The serious concerns raised by a straightforward market concentration analysis for physical units are only confirmed by other factors in this merger. In this market, the same small number of firms have been at the top of the music industry for almost a quarter of a century, in spite of two major changes in technology that caused dramatic change in the cost of production and the nature of the product. The market has also historically been a very high-margin business, and the dominant firms have a history of anti-consumer behavior, such as when the major labels colluded to illegally fix prices in the mid-1990s.³

4. **During the hearing, you stated that “there’s absolutely no evidence, and the proponents of the merger have not presented any evidence that piracy exerts any downward pressure on prices whatsoever.” Could you explain why you believe piracy has no effect at all on price of recorded music?**

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³ *The Case Against the Universal-EMI Merger* at 12-18.
Claims that the piracy will prevent anticompetitive harms should the merger be consummated are not supported by the facts, and empirical analysis actually leads to the opposite conclusion. Last year alone, consumers spent almost $2.5 billion on digital music products, showing a strong desire by consumers to access music legally. If consumers today are willing to pay an average of $10.40 per digital album, why would they suddenly resort to piracy if the price went up to $1? It is this power of the dominant firms to arbitrarily raise prices without being disciplined by corresponding decreases in quantity demanded that merger review focuses on.

Piracy’s inability to discipline the major labels is evident from the majors’ behavior. After all, piracy exists today, but major labels are consistently resistant to new digital distribution models that are responsive to consumer demand. The major labels have also managed to raise prices for some singles on iTunes from $0.99 to $1.29, a move they would not be able to make if piracy was preventing them from raising prices.

The major labels’ past behavior also shows that piracy does not stop the major labels from raising prices, even to anti-competitive levels. In the mid-1990s, the major labels adopted two practices designed to resist innovation and prop up profits at the expense of consumers. The labels entered into a price-fixing scheme to maintain high album prices despite their dramatically decreased costs of production for CDs. They also eliminated the sale of singles, even though previous sales had indicated significant consumer demand for singles, to force consumers to purchase more expensive (and more profitable) albums. The major labels eventually settled antitrust lawsuits brought by the Federal Trade Commission and state Attorneys General, ending the anticompetitive schemes. Shortly thereafter, the sales of singles skyrocketed, from 8.4 million singles in 2002 to 1.2 billion singles in 2010, and record labels once again began to respond to downward pricing pressure.

It is important to remember that these antitrust violations occurred at a time when the market was less concentrated than it is today. If piracy had created the downward pricing pressure that merger proponents claim, those price fixing schemes would have been unprofitable because they would have driven more consumers to infringe.

5. Do you believe there are any conditions that the FTC should place on the Universal Music/EMI merger, should the agency decide to approve it, and, if so, what are they?

Neither divestitures nor behavioral conditions would be able to fully mitigate the harms of this merger. The FTC would have difficulty determining which sub-labels the combined UMG/EMI should divest, because each label has a unique catalogue, and even if the antitrust authorities could somehow achieve three equal-sized majors, the market would still have lost a maverick fourth competitor. Behavioral conditions, like licensing conditions, are only effective if they are rigorously monitored and enforced, and as we can see by the Comcast-NBCU merger, they rarely are.

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4 The Case Against the Universal-EMI Merger at 12-15.
Public Knowledge (Gigi Sohn)

1. At the hearing, I asked you if the merger would result in a more efficient allocation of EMI’s resources. You did not directly answer my question. Please give me a direct answer to that question.
   - Would this merger result in increased output and a more efficient use of resources than EMI is currently able to achieve?

Universal Music Group (UMG) and EMI have put forward no public information that explains exactly how they would more efficiently allocate EMI’s resources. UMG has made no specific claim that they would invest more in EMI artists or utilize EMI’s resources in a way that a standalone EMI could not do today. Public Knowledge would welcome UMG to explicitly state what levels of new resources they are willing to commit to developing EMI’s artists.

Public Knowledge believes that no increase in efficiency of resources in regards to artists’ development would occur as a result of bringing EMI’s artists and labels under the UMG umbrella. It is possible that the only efficiency a combined UMG and EMI could bring to the market is reduced costs by shedding jobs in distribution and backend operations. We are seeing this now with the Sony acquisition of EMI Music Publishing where around 40 jobs have been immediately eliminated with a predicted 326 jobs to be eliminated over the next two years.¹ In any event, such a limited efficiency gain that the merged entity could achieve would be strongly outweighed by the anticompetitive harms that would result from controlling 41% of the market.

It is also worth noting that the record label industry cannot achieve efficiencies in artists and repertoire (A&R) investment through consolidation. Each sub-label needs its own A&R division to understand the genre of music they are developing and recruit talent. The merged super-label would not be able to eliminate one A&R division and expect another of a different genre to adequately substitute for it. This is particularly noteworthy given that the core purpose of a record label, at a time of near zero distribution costs through the Internet, is to recruit and develop artists.

Lastly, Public Knowledge believes that claims of EMI’s demise and incapacity to develop artists without UMG’s assistance are vastly overstated. Recent reports have shown that EMI is currently in strong financial health. EMI has earned steadily growing profits in recent years, from 5.6% in 2007-08 to an industry-leading 17% profit margin in 2010-11. EMI was also able to successfully bring to market two of the top five songs for 2011 demonstrating that it can effectively compete with its rivals. Even EMI’s own CEO Roger Faxon told the Los Angeles

Times last year that the company has "a very strong underlying business, and with the Citigroup recapitalization, we have the strongest balance sheet in the business with 2/3 less debt and 300 million pounds [about $480M] of cash to boot."
SUBMISSIONS FOR THE RECORD

The American Antitrust Institute

Written Statement of
THE AMERICAN ANTITRUST INSTITUTE

Before the
SENATE JUDICIARY COMMITTEE, SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

Hearing on
UNIVERSAL MUSIC GROUP'S PROPOSED ACQUISITION OF EMI'S RECORDED MUSIC DIVISION

June 21, 2012

Chairman Kohl, Ranking Member Lee, and members of the Subcommittee:

The American Antitrust Institute (AAI) is an independent non-profit consumer organization devoted to enhancing the role of competition in the economy and sustaining the vitality of the antitrust laws.¹ We believe that competition benefits consumers and the economy by lowering prices, promoting innovation, elevating customer service, and enhancing the choices available to consumers.

Thank you for this opportunity to comment on the competitive issues posed by Universal Music Group's proposed acquisition of EMI's recorded music division, which is currently under investigation by the Federal Trade Commission. As the Subcommittee is well aware, digital distribution and sale of media over the Internet has been a bellwether in the consumer-friendly evolution of the music industry during the first decade of the 21st Century. It has helped to better connect new and old artists with new and old fans, with greater ease and less expense, and using a

¹ AAI is managed by its Board of Directors with the guidance of an Advisory Board consisting of more than 130 prominent antitrust lawyers, economists, and business leaders. The Board of Directors alone has approved this written testimony; individual views of members of the Advisory Board may differ from AAI's positions.
widening array of innovative business, sales and platform models, made possible partly by a market environment that, while too constrained, still allows for some competition.

The AAI commends this Subcommittee for conducting this hearing and exploring the important question of whether Universal Music Group’s proposed acquisition of EMI’s recorded music division threatens to derail this evolution and put the recorded music industry on the wrong course. Members of the Subcommittee will hear an array of views from thoughtful, knowledgeable experts, who likely will address questions having to do with, among other things: the nature of the recorded music industry; market definition and the status of competition in the industry’s digital versus physical segments; the role of independent labels; music as a heterogenous product, and questions of market definition and market power within individual musical genres; the proposed transaction’s potential adverse monopoly power effect on artists; the role of the major labels in promoting artists as a potential entry barrier; piracy; and the role of copyright law in assuring some but not other digital distributors of access to music at reasonable license rates. All of these inquiries are important and merit close scrutiny.

In this brief statement, the AAI wishes to highlight just two considerations that it deems significant, and that help elucidate the proposed acquisition’s likely competitive effects. One is that the effects of further concentration in a total recorded music relevant market and/or digital recorded music relevant market will be amplified by the recorded music industry’s unique characteristics. The other is that the depth and scope of harm to the important digital segment of the market will be amplified by the proposed transaction’s likely impact on innovation incentives. Innovation incentives are of particular concern to the digital segment of the recorded music market because that segment is technology driven and organized around nascent platform competition.

The AAI believes that each of these considerations raises the stakes of getting right—and the consequences of getting wrong—predictions about the proposed acquisition’s likely competitive
effects. Upon discussing each of these factors in the remainder of this statement, we also address the reliability of potential mitigating factors like powerful buyers (such as Apple), illegal music piracy, and competing independent labels. We conclude by explaining why we are concerned that the merger poses too great a risk to competition, and we discuss remedies.

**Market Facts Suggest that Concentration Merits Concern**

Concentration, especially at advanced levels, is generally disfavored in any industry for reasons long since established in economics and public policy. However, its effects are even more pernicious (1) in media industries, where diversity among literary, artistic and political expressions, and variety among the choices available to consumers, are inextricably intertwined with our highest cultural and democratic values, and (2) in “platform” industries, where complex technology drives commerce, and phenomena like network effects and “tipping” therefore threaten inefficient outcomes whereby dominant incumbents successfully impose inferior models on an unwitting public. Recorded music in 2012 is both a media industry and a platform industry, and if Universal’s proposed acquisition of EMI is not enjoined, it will be a highly concentrated industry.

Even if the proposed transaction didn’t involve a media industry recovering from a digital technology revolution, a structural view of the total recorded music market in the United States in a post-merger world, by itself, should give regulators pause. In taking the number of companies that control approximately 90% of the market from 4 to 3, the merger appears very clearly to leave the total recorded music industry vulnerable to the kind of anticompetitive, welfare-diminishing abuses the antitrust laws were designed to prevent.

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However, concentration is but one aspect of a multi-faceted inquiry under modern merger analysis, which flows from the 2010 DOJ-FTC Horizontal Merger Guidelines ("Guidelines"). Merger review under the modern Guidelines is a “fact specific process through which the Agencies . . . apply a range of analytical tools” and “consider any reasonably available and reliable evidence to address the central question of whether a merger may substantially lessen competition.” It is therefore important to examine not just the severity of concentration in a market, but its likely actual effects, which may be more or less problematic than raw numbers suggest.

At the end of 2011, according to Nielsen and Billboard, album sales market shares in the total recorded music market, the physical market, and the digital market were as follows:

| TABLE 1: 2011 YEAR-TO-DATE RECORD COMPANY MARKET SHARE (1/3/11 - 1/1/12) (Reflects the market share for the entire entity including sub-distributed companies for the 52 week year) |
|---|---|---|---|---|---|---|---|
| **TOTAL ALBUMS** (Catalog & Current Titles) | **PHYSICAL ALBUMS** (Catalog & Current Titles) | **DIGITAL ALBUMS** (Catalog & Current Titles) |
| UMG | 29.85% | 30.84% | UMG | 30.53% | 32.06% | UMG | 28.35% | 27.47% |
| SME | 29.29% | 27.95% | SME | 31.08% | 29.31% | SME | 25.36% | 24.18% |
| WMG | 19.13% | 20.01% | WMG | 18.78% | 19.07% | WMG | 19.91% | 22.69% |
| EMI | 9.62% | 10.18% | EMI | 9.44% | 9.99% | EMI | 10.00% | 10.71% |
| OTHERS | 12.11% | 11.02% | OTHERS | 10.17% | 9.57% | OTHERS | 16.37% | 15.03% |

As of the beginning of 2012, the “Big Four” major record labels thus control almost 90% of the total recorded music market, and the market scores a 2,208 on the Herfindahl-Hirschman Index (2,208 “HHIs”), rendering it “moderately concentrated” according to the Guidelines. A hypothetical merged Universal/EMI would have had nearly 40% of the market in 2011, leaving only Sony with nearly 30% and Warner with less than 20% among rival “majors.” This 4-3 reduction

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5 Guidelines §§ 1, 2.


5 Guidelines § 3.3.
would take the market from “moderately concentrated” to “highly concentrated” under the Guidelines, and at 2,782 HHIs, or an increase of 574 HHIs, the proposed acquisition nearly triples the HHI increase threshold for acquisitions that are “presumed to be likely to enhance market power.” Structurally, at least, the transaction is therefore presumptively anticompetitive by a wide margin.

To be sure, concentration is but “one useful indicator of likely competitive effects,” and the Guidelines counsel that market shares are to be “used in conjunction with other evidence.” But the Guidelines also stress that “The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs,” which may be probative of the unlikelihood that any remaining rivals will replace the competition lost by the elimination of one of the acquiring firm’s rivals. Market shares in the recorded music industry have been remarkably stable from 2006-2012 despite a massive industry transformation, which drastically altered distribution and pricing practices and caused revenues to plummet, and which immediately preceded this six-year time period.

Norwithstanding the advent of MP3 technology in the 1990s and the subsequent growth of digital music platforms offering a la carte pricing, most notably iTunes beginning in 2003, no major

\[\text{\textsuperscript{7}}\text{ Id. A question remains as to whether physical sales and digital sales fall within the same relevant product market. However, if digital and physical recorded music are separate, narrower relevant product markets, the concentration effect of the proposed transaction does not change. In the digital market, the transaction remains a 4-5, with HHIs going from 1943 to 2510, for an increase of 567. In the physical market, the transaction remains a 4-3, with HHIs going from 2240 to 2917, for an increase of 577. Thus, regardless of whether one analyzes a total recorded music market or separate digital and physical recorded music markets, the transaction takes the market in question from moderately concentrated to highly concentrated, and it nearly triples the HHI increase threshold for acquisitions that are “presumed to be likely to enhance market power.” Id. An analysis of the concentration effect of the merger in still narrower relevant products, such as genre-specific markets, likely requires non-public information and is beyond the scope of this paper. However, genre-specific anticompetitive harm is a serious risk and deserves close scrutiny from government authorities.}\]

\[\text{\textsuperscript{8} Id.}\]

\[\text{\textsuperscript{9} Id.}\]

\[\text{\textsuperscript{10} See David Goldman, Music’s Last Decade: Sales Cut in Half, CNN Money, http://money.cnn.com/2010/02/02/news/companies/mApple_music_industry/ (citing a Forrester Research forecast using data from the Recording Industry Association of America that shows a decline from $14.6 billion to $6.3 billion in total revenue from music sales and licensing during 1999-2009).}\]
record company has seen its market share in total album sales increase or decrease by more than 4.32% in six years’ time.\textsuperscript{11} Apart from Sony, whose share of total album sales grew from 24.97% in 2007 to 29.29% in 2011, no major has seen its market share move in any direction by more than 2.25% in that time.\textsuperscript{12}

\begin{table}[h]
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\begin{tabular}{|c|c|c|c|c|c|c|}
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UMG & 29.85\% & 30.84\% & 30.20\% & 31.52\% & 31.90\% & 31.61\% \\
SME & 29.29\% & 27.95\% & 28.58\% & 25.30\% & 24.97\% & 27.44\% \\
\hline
OTHER & 12.11\% & 11.02\% & 11.47\% & 12.83\% & 13.48\% & 12.61\% \\
\hline
\end{tabular}
\caption{Record Company Market Share, 2006-2012 — Total Albums (Catalog & current titles) (Reflects the market share for the entire entity including sub-distributed companies for the 52 week year)\textsuperscript{13}}
\end{table}

Perhaps even more notably, market shares are about equally stable in the still nascent digital segments of the industry. Tables 3 and 4 below show that no major’s share of digital album sales or digital track sales moved more than 5.37\% or 3.13\%, respectively, from 2006-2012.

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UMG & 28.35\% & 27.47\% & 26.92\% & 27.80\% & 22.98\% & 27.35\% \\
\hline
\end{tabular}
\caption{Record Company Market Share, 2006-2012 — Digital Albums (Catalog & then-current titles) (Reflects the market share for the entire entity including sub-distributed companies for the 52 week year)\textsuperscript{14}}
\end{table}

\textsuperscript{11} See infra Table 2.
\textsuperscript{12} Id.
\textsuperscript{14} See supra note 13.
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<tr>
<td>Sony-BMG</td>
<td>25.36%</td>
<td>24.18%</td>
<td>24.21%</td>
<td>21.36%</td>
<td>22.86%</td>
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<td>WMG</td>
<td>19.91%</td>
<td>22.60%</td>
<td>22.80%</td>
<td>23.48%</td>
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<td>EMI</td>
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<td>10.71%</td>
<td>9.92%</td>
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</tr>
<tr>
<td>OTHER</td>
<td>16.37%</td>
<td>13.03%</td>
<td>16.14%</td>
<td>16.50%</td>
<td>15.67%</td>
<td>15.37%</td>
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**TABLE 4: RECORD COMPANY MARKET SHARE 2006-2012 – DIGITAL TRACKS** (Reflects the market share for the entire entity including sub-distributed companies for the 52 week year)\(^6\)

That market shares have remained stable over the last six years is not conclusive evidence that concentration will cause harm to consumers,\(^6\) but it should raise concerns. First, it raises questions as to whether high barriers to entry remain in the digital and total recorded music markets, despite the advent of digital distribution, which some argue has leveled the playing field for independent labels. This belief is hard to square with independents’ market share, which has not changed meaningfully in either the digital segment or overall.

\(^6\) See supra note 13.

\(^6\) The Guidelines, for example, are "especially" concerned with stable market shares when they appear "in the face of historical changes in relative prices or costs." Guidelines § 5.3 (emphasis added). In the recorded music industry, the advent of digital music did not cause prices to plummet for one major label relative to another, but rather for all majors. Available data is therefore inconclusive on the question whether a firm would maintain market share if it raised prices relative to a rival.
Second, it should raise questions as to whether the post-merger market would be left vulnerable to anticompetitive oligopolistic conduct. If there is a likelihood that Sony and Warner would perceive they are unlikely to take market share from Universal/EMI, the three firms are more likely to consciously act in parallel in making pricing and other strategic decisions, such as which platforms should receive music licenses and on what terms. This latter issue is discussed more fully in the next section.

The Merger Threatens to Negatively Impact Innovation Incentives

Our second point of emphasis in this statement is that the proposed transaction threatens to negatively impact innovation incentives, which is of particular concern in a technology market organized around nascent platform competition. It is particularly important to nurture and protect innovation in high tech industries because consumers will often have difficulty adopting and navigating multiple complex, competing, technology-driven products. As a result, so-called “network effects” can lead a single product quickly to dominance, and the market can “tip” to that product.

Fortunately, in the two-sided market for online digital music services, platform innovation has flourished over the last decade. Consumers can now choose from Internet radio stations, non-interactive streaming services like Pandora, interactive streaming services like Spotify, and downloading services like iTunes. More recently, “cloud lockers” that provide near omnipresent access to music through all manner of electronic devices have begun to emerge, with services now being offered by Apple, Google and Amazon, among others. Competition to become the platform of choice for audiophiles has clearly encouraged service providers to innovate, with the result that consumers enjoy a wealth of options, most of which have the central purpose of getting music to consumers for lower prices and with greater convenience.
Among online music services, the music itself is an obviously essential input, and the input cannot be sourced to a lone supplier; online music services require access to all the major labels’ catalogues of music in order to effectively compete, because they must appeal to a very wide variety of consumer preferences. In the current “Big Four” world, new online music services entrants can launch with the backing of any of the four major labels (though perhaps only after the label extracts onerous concessions17), and if the platform proves attractive, the remaining three labels will often follow suit on similar terms, even if those terms are not ideal. Although one or more firms may hold out for more money, the remaining labels (particularly the fourth once the first three have signed) usually cannot justify the foregone licensing revenue to their constituencies for very long. Thus services like iTunes, Spotify, and Amazon’s MP3 Store initially signed with just one label, and in each case it was a different label, while all now have deals with all four majors.18

Post merger, Universal would be the sponsoring label superhead. The mere perception that a single dominant firm, or three firms with market power consciously acting in parallel, can leverage access to an essential input inevitably would dissuade rational investors from innovating in platform and business models. Likewise, Sony and Warner would have no reason to sponsor new entry by licensing their respective catalogues to new platforms, because the new entrant could not possibly compete without Universal’s catalogue. The two remaining labels would base all negotiations of licensing terms, or they would refuse to negotiate, depending entirely on what they know or suspect to be Universal’s preferences, effectively awarding Universal a de facto gatekeeper role.

Consider, for example, the Spotify interactive streaming service’s introduction to the U.S. market. Spotify is a Sweden-based company that offers a three-tiered system of interactive access to a vast catalogue of music: a free, ad-supported version, a basic, ad-free version for a small fee, and a premium version for a slightly larger fee. Spotify users can access and play nearly any song they wish, while making and sharing playlists with friends. The company launched in Europe in 2008 and proved to be extremely popular, generating 10 million worldwide users by the middle of 2011. After first seeking to enter the U.S. market in 2009, the company got bogged down in negotiations with the record labels for nearly two years. In January 2011, it finally struck its first U.S. deal with Sony. In February, it reached a deal with EMI. After a further hold out period, during which time Spotify was compelled to impose a number of limitations on its service to placate the remaining labels, it finally reached terms with Universal in June. Weeks later, it signed with Warner and promptly launched in July. By August, the service was already boasting 1.4 million U.S. subscribers.

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21 Id.
23 Peter Kafka, Spotify Signs On EMI for U.S. Launch: At Least One More to Go..., All Things D, Feb. 17, 2011, http://allthingd.com/20110217/spotify-signs-on-emi-for-us-launch-at-least-one-more-to-go/. Analysts at the time warned that the company’s U.S. launch was still tenuous. Id. (“Spotify now has the approval from two of the four major music labels for an American launch. But that still doesn’t guarantee you’ll see the streaming music subscription service in America anytime soon. In order to make a credible offer to U.S. users, Spotify will need to at least get Universal Music Group, the world’s biggest label, on board, and it’s not there yet.”)
subscribers. By January 2012, it was gaining subscribers at a rate faster than both Sirius XM
and Netflix.

In a post-merger world, it seems very likely that Spotify would have never launched in the
U.S., unless in a transnogriphized state, and consumers would have been deprived of an innovative
new offering. In the “Big Four” world, the process took nearly two years, and the service could not
sign with Universal until it imposed limitations that allowed users to play each track only five times
for free, with a cap on total music listening of 10 hours per month. Michael Robertson, an
industry veteran, has detailed further concessions that the labels were reportedly able to extract from
Spotify, as well as his own company, MP3.com, and other interactive streaming services, including
(1) price floors, minimum payments and/or revenue shares in the subscription; (2) an equity stake in
the subscription; (3) upfront payments; (4) detailed reporting obligations; (5) most-favored nations
classes vis-à-vis other labels; and (6) non-disclosure provisions.

In the post-merger world, Sony would have had no incentive to sponsor Spotify’s U.S. entry,
its belief in the service notwithstanding, because no pressure could be brought to bear on Universal.
If Sony or Warner were to sign with a Spotify prior to Universal, it would only be in anticipation of,
and subject to, the terms Universal sought from the service, which would be as onerous as Universal
saw fit. In short, the Spotify story would likely have had a very different ending, one that serves as a
cautionary tale about the negative impact that a merged Universal/EMI can be expected to have on

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27 Peter Kafka, Spotify’s U.S. Score So Far: 1.4 Million Users, 175,000 Paying Customers, All Things D, Aug. 8, 2011,
http://allthingsd.com/20110808/spotify-s-u-s-score-so-far-1-4-million-users-175000-paying-customers/
28 Austin Carr, Spotify Growing By 8,000 Subscribers Per Day, More Than Netflix, Sirius XM, Fast Company, Jan. 26, 2012,
http://www.fastcompany.com/1811680/spotify-growing-by-8000-subscribers-per-day-more-than-netflix-sirius-xm
limited/.
30 Michael Robertson, Why Spotify Can Never Be Profitable: The Secret Demands of Record Labels, GigaOM, Dec. 11, 2011,
the innovation incentives for both new platform providers and the remaining major music labels in the United States.

Mitigating Factors Are Unlikely to Save Competitive Dynamics

Supporters of the proposed acquisition have argued that mitigating factors in the industry would help to preserve competitive dynamics in the interaction between labels and digital distributors. Most notably, it is suggested that powerful buyers, like Apple, the threat of music piracy, and the newfound ability of independent labels to grow in an unencumbered digital environment, would keep the consolidated digital recorded music industry in check. The AAI does not believe that any of these factors can be relied upon to preserve competition.

Apple clearly has very large market share in the digital music download market, reported to be approximately 70% in 2011, and it currently boasts the highest market capitalization of any company in the world. Apple's unique success, however, will not constrain the music labels, because Apple is dependent on access to a robust music catalogue to maintain the market positions of its devices. The Guidelines suggest two ways in which a powerful buyer can constrain sellers: by credibly threatening to enter upstream, or by undermining coordinated effects. Here, there is no reason to suspect that Apple will enter the music business. And there is no reason to suspect Apple will undermine coordination because it is not choosing one supplier over another, but rather must have deals with all the suppliers, as discussed above. If anything, having fewer major labels with which to negotiate would only undermine any leverage Apple might otherwise enjoy. Moreover, as

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\[3\] Guidelines § 8.
its dispute with the Department of Justice concerning the fixing of e-book prices makes clear, any early "loss leader" strategy whereby Apple would keep content prices low to sell more of its new devices will eventually give way to a more profitable strategy that stabilizes higher prices among all distributors. Apple cannot be relied upon to stand in the way of content providers, who it views as its partners, and thus it cannot be relied upon to preserve competition in the digital recorded music market.

Music piracy, likewise, is not a credible threat to constrain a consolidated digital recorded music industry. Although piracy is a serious problem, it is a red herring in the context of the proposed transaction. Piracy may reduce the labels' total revenues, but it has no impact on marginal revenues, and thus does not constrain pricing. Consumers willing to download music illegally would likely do so at any price, and consumers who are unwilling to break the law will not turn to piracy as a substitute. Moreover, piracy only worsens the problem of reduced innovation incentives, if it affects innovation incentives at all. The piracy problem is a salient national issue that sooner or later will likely be reduced and/or eliminated. The proposed transaction has to be viewed as permanent. Piracy is not a justification for the merger.

Finally, it is not feasible to hope the rise of independent labels will counteract the competitive effects of the transaction. It is true that independents are no longer forced out of the market by limitations on physical space in brick and mortar record stores, but the stability of recorded music market shares over time explodes the notion that independents are faring better in a digital world. As Table 3 above shows, the independents' share of digital track and digital album sales have in fact declined since 2008. Likewise their total album sales.

Conclusion

\[\text{\textsuperscript{4}}\text{ See U.S. v. Apple, No. 12-CV-2826 (S.D.N.Y. filed Apr. 11, 2012).}\]
For all of the above reasons, the AAI believes that the proposed acquisition poses too great a risk of harm to competition and consumers, without reliable mitigating factors. If regulators are to act, a question will arise as to whether the proposed transaction must be enjoined, or if the risk of harm may be ameliorated by other structural relief or by behavioral relief. The efficacy of a structural remedy short of an injunction may depend in part on questions of market definition, some of which the AAI cannot fully address because of limitations on access to data.35 However, we caution that a behavioral remedy should be avoided.

Behavioral remedies are inferior to structural remedies in terms of clarity, cost and certainty, and they should arguably always yield to structural remedies in horizontal cases.36 They require ongoing government monitoring and compliance enforcement, and often suffer from problems associated with traditional industry regulation, ranging from countervailing incentives to implementation costs.37 Recent studies have corroborated doubt about the efficacy of behavioral remedies and shown that mergers subject to conduct relief have resulted in higher price increases than mergers subject to divestitures.38 The AAI believes the best remedy for a horizontal merger in which divestitures will not clearly solve all competitive problems is to “just say no.”

35 See supra note 7.
37 Id.
TESTIMONY OF IRVING AZOFF

Executive Chairman and Chairman of the Board
Live Nation Entertainment, Inc.
Chairman and Chief Executive Officer, Front Line Management Group

Before the Subcommittee on Antitrust, Competition Policy and Consumer Rights
Senate Judiciary Committee

June 21, 2012

I grew up in Danville, Illinois, a mid American town with all American ideals, and briefly attended the University of Illinois. For more than 43 years in the music business, I've focused on one thing — serving artists. The music industry I joined was a vibrant, emerging and entrepreneurial business whose format of choice was vinyl. Throughout all the changes -- vinyl, four- and eight-track, cassette and compact disc -- one thing remained constant: the power of the record label. The emergence of the internet has changed that.

I work with acts big and small, some that are household names and some who should be but just haven't yet gotten there yet. Let me be very clear -- none of them have to sign to a major label anymore. Majors cannot sign every act, and the door is open for many others to do so.

In fact, independent labels are capturing more and more market share every year -- it's grown from 23% up to 30% in the last decade. Bon Iver of Jagjaguwar won the Grammy for best new artist this year. Esperanza Spaulding
of Concord won it last year. And Mr. Mills' XL brought us the biggest selling artist of 2011, Adele.

Approximately 40% of Front Line artists aren't even on labels. I have no doubt that labels add value, but you just don't have to have one in a world where artists can deliver an album direct to fans themselves. It's a little like hiring an interior decorator to re-do your house. The experience and results can be great but some acts enjoy and prefer to do it on their own and put their own imprint on things. And with services like iTunes, CD Baby, Top Spin, Reverb Nation, Pro Tools, Facebook, Spotify – you name it – artists can do everything themselves very professionally.

It used to be that bands couldn't make a professional album without the backing of a label. Labels used to be THE gatekeepers to fans. But today, those barriers have been blown away. The new gatekeepers are the fans. Facebook and other social media make fans the essential promotional power. If a fan "likes" a song, and tells a friend or two or ten thousand, a band is on their way. The power today rests with consumers – not record labels. So while the Internet has brought challenges for many, it has also given bands opportunities, access, and control previously unknown to any generation of artists.

The reason a combined EMI-UMG is a good thing rests in the much bigger picture. Our industry has been turned on its head in the last decade. With all the
great developments the internet has brought us, the economics are still daunting. Most musicians make a living today from touring – not record sales as they once did. And it makes sense, since consumers aren’t buying $15 CDs any more, they’re paying for a single track download from Amazon or iTunes or listening to ad-supported services that result in mere fractions of a penny-per-play being paid to the artist – or worse, still, they just go to a torrent site and get it for free. Late to embrace the Internet, labels are playing catch-up – but any way you slice it, recorded music sales are still the core of a label’s business model.

Those who speculate about the demise of competition simply don’t live in the hyper competitive music world that I see every day. Competition is fierce between the major labels, and fierce between the majors and the indies. Competition is fierce in distribution as new online and mobile services vie against one another and against Apple.

As for the broo-ha-ha around this deal, Mr. Bronfman has been talking about combining Warner and EMI for the better part of a decade. The entire industry expected it to happen, Wall Street expected it to happen, journalists expected it to happen. Warner had a chance to outbid Universal in this process – but chose to walk away. Now, they regret their decision, and are spending millions to fight the deal. Well, I don’t think the government should step in to give them another bite at the apple – that is not how our free market economy works.
The fact is, it would have been great if EMI could have made a go of it on its own. But the recession, piracy, and the facts surrounding Terra Firma and Citi combined to make that a pipe dream. The aura of uncertainty made EMI a risky place for an artist to sign. This business is about relationships, and confidence that the team you sign with will be right beside you throughout the entire journey. Uncertainty made it hard for EMI to sign new acts, and even harder to keep proven winners. With Universal taking over, and their commitment to resurrecting Capitol Records, there will actually be another record company for artists to explore, if they want to. As I see it, it is not one less company – it is one more choice.

Bottom line: The people concerned that a combined EMI-UMG would have too much “power” really just don’t get what has happened to this business over the last decade. Labels don’t control artists. Those days are gone. And no label in the world can control the supremacy of the modern music fan. The power shift has already taken place – and no one should worry for a minute that it rests with the labels any longer.
June 18, 2012

The Honorable Herb Kohl
Chairman, Subcommittee on Antitrust
Committee on the Judiciary
United States Senate
330 Hart Senate Office Building
Washington, DC 20510

Dear Senator Kohl,

I am deeply hopeful you will support EMI and Universal Music Group in their pending alliance.

I’ve worked with one of Universal Music’s labels for years. Each album we completed marked a point of profound growth and evolution for me, and I’m deeply thankful to have shared the road with a company that supported and nurtured me throughout the journey.

It’s through that experience that I know Universal is uniquely qualified to help move our industry forward. I know if Universal Music is given the opportunity, they will lead EMI brilliantly and empower EMI artists – and generations of treasured artists to come – as they have me.

Our business is complicated and has undergone tremendous change over the past several years. But one basic truth has never waned. Music – and artistry – is important, beautiful and bears witness to our human condition. The business of sustaining that truth drives my Universal family. They have proven their commitment to the artists and the future of our business and deserve to guide EMI in its days ahead.

With blessings to you,

Mary J. Blige
Singer and Songwriter
Good afternoon, Chairman Kohl, Ranking Member Lee and Members of the Subcommittee.

I am Edgar Bronfman, Jr. I am a director of Warner Music Group and I’m Co-Chairman of the Board’s Digital Committee. Beginning in 2004, I served for seven years as Chairman and CEO of Warner. Thank you for giving me the opportunity to explain to you why the proposed takeover of EMI Music by Universal Music Group, which would create a “supermajor” almost as large as the other two majors combined, would be bad for the music industry, bad for digital innovation and bad for American consumers.

The Federal Trade Commission is currently reviewing this merger. I believe that if the FTC allowed this takeover to occur, the combined Universal/EMI would possess far too much power, resulting in grave consequences for consumers and the future of digital innovation. Therefore, I urge this Subcommittee to recognize this danger and I urge the FTC to block the acquisition, thus ensuring a competitive marketplace that would foster continued innovation driven by consumer demand. Although Universal wants to buy EMI, if this deal goes ahead it would be consumers who would end up paying the price.

I know this territory very well. I’ve spent much of my career – more than 37 years – in the music industry. I actually started out as a songwriter in the 1970’s, but for the last 20 years my primary contributions to the industry have been as an executive and an investor. Prior to my tenure at Warner, in my roles as COO and CEO of Seagram and Vice Chairman of Vivendi, I was a key player in the formation and growth of Universal Music Group. I care deeply about the health of the music industry and its myriad constituents. And I should add that I’ve long known Lucian Grainge, Roger Faxon, Martin Mills and Irving Azoff, and I respect them. But the issue before us is not the integrity of the executives; rather it is how the proposed merger would fundamentally change the competitive structure of the market.
The Music Industry Today

First, let me provide some background on where the music industry is today and why this hearing is so important.

Over the past decade, digital technology has transformed media and entertainment. Music has led the way, blazing a trail that other content industries have followed. Consumers have been the beneficiaries. They now enjoy a vast range of choices in how and where they experience music. Consumers who care about music currently enjoy a wider variety of value propositions and price points than ever before. As a result, more consumers pay for music online than pay for any other form of digital content.¹ It is no surprise, given the ubiquity of music in people’s lives as enabled by technological innovation, that almost three-quarters of Americans consider themselves passionate about music.² And yet, we are still at an early stage in music’s digital transformation. A Forrester research analyst recently noted, “Current digital music products are essentially transition technologies that were useful for bridging the gap between the analogue and digital worlds, but now it’s time to start the digital journey in earnest.”³

Cutting-edge digital music services have not only given consumers a broad array of choices in how to access and listen to music, they have become a critical factor in driving new platform adoption and broadband penetration, fueling the digital economy. If this merger were allowed to go through, this dynamic convergence of media and technology, which has demonstrably benefitted consumers, could be dramatically disrupted, even derailed. Because of the way digital rights are negotiated, one firm, Universal/EMI, would be in a position to pick winners and losers among digital music services. This gatekeeper could block any service that did not give it the deal terms it sought, resulting in fewer choices and higher prices. With Universal/EMI dictating the scope of innovation, and “taxing” it, consumers would bear the consequences.

To understand the nature of the issue, it’s important to dispel two common misconceptions about the current state of the music industry.

Perhaps the biggest misconception is that record labels are irrelevant, which is based on the erroneous view that record companies provide only a distribution service. That isn’t at all the case. The value-add that record companies – much like other creative content companies – provide is that they discover, sign and invest in talented artists who can captivate a discerning public, and then they market and promote those artists. That’s what companies like Warner do. When we do it – and do it well – we produce jobs and exports, as well as meaningful art and entertainment. I know we all love the mystique surrounding the notion of “garage bands”, but

the truth is that virtually no artists have achieved long-term, meaningful commercial success without being signed to a record label. The role of record labels is still vital.

The second misconception is about the health of the record business. The industry today is about half the size it was in 1999. But after more than a decade of declining sales, rampant piracy and the transition to a digital world, the industry has turned a corner. We are growing again. The RIAA recently reported that in 2011 total U.S. music shipments were up for the first time since 2004, the number of users of music subscription services jumped 19% and digital single sales were up 13%.

The critical part of this growth is digital. By the end of 2011, according to SoundScan, digital downloads accounted for more than 50% of all recorded music unit sales in the U.S., overtaking physical unit sales for the first time. As an industry, we are figuring out how to give consumers what they want, digitally, and, as a result, we are reversing a more-than-decade-long negative trend. A report just issued by PricewaterhouseCoopers forecasts that the continued rise of subscription-based streaming music services and digital downloads are projected to help the U.S. recorded music market grow by 17.9% over the next five years. The proposed Universal/EMI merger must be viewed against this backdrop. This is the worst possible time to allow Universal to lock in an unfair competitive advantage by buying market share and market power.

The Convergence of Digital Technology and Content

There is a story that really epitomizes what this hearing is all about.

It’s about an entrepreneur from a technology company who came to pitch Warner on a truly disruptive idea in 2002 – a digital music “start-up”. His company was a great innovator but frankly hadn’t seen significant growth in years. Yet, this person believed he could reshape the way consumers experience music.

That entrepreneur was Steve Jobs. The company was Apple. The start-up was iTunes.

Even though at the time Warner was only one of five majors and had only 17% U.S. market share, it was the first music major to sign a deal with Apple and played an instrumental role in helping bring iTunes to market. Warner worked closely with Apple to shape the iTunes experience. Warner spent months going over every aspect of the service. And when the Warner deal was signed, Apple got its foot in the door with its revolutionary concept validated. That provided the foundation Apple needed to advance iTunes – which was then only an idea – to become what it is today – an innovation juggernaut. After Warner came on board, Apple was

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able to shop the Warner deal around to the then-other four majors and eventually secured deals with Universal, EMI, Sony and BMG.

The rest is history. In 2002, Apple was a relatively small but successful company. Today, it is the most valuable company in the world.5 By creating iTunes, Apple unleashed the tremendous power of the “connected economy” at the vital intersection between technology and media.

This “ancient history” from 2002 — related in Walter Isaacson’s recent biography of Steve Jobs — is relevant for two reasons.

First, it shows how music innovation drives the broader convergence between digital technology and content. Music led the way. Everything else followed — from movies to television shows to books and magazines. And that is still the case: Apple’s content platform is still called iTunes and consumer engagement is still predominantly around music.6 The future of music innovation, which we are here to discuss today, is critical not just to the music industry but to every member of the content and technology communities and, above all else, to consumers.

Second, as I will discuss later, the sequential negotiation deal-making technique Apple used a decade ago in striking deals with the majors is the same technique used by all digital music services to make deals today. But the technique only works in a robust, vigorously competitive record market — a market where any major, no matter its size, can be the sponsor of innovation, as Warner was with iTunes. The proposed merger would destroy that dynamic by creating a “supermajor” with sufficient market power to prevent any new service it perceives as disruptive from launching successfully. Universal/EMI would become the troll guarding the bridge, exacting a toll on innovation, maybe even blocking it, depriving consumers of what they want.

Concentration in the Music Industry

Fifteen years ago there were six majors. Today there are four. A Universal/EMI merger would reduce that number to three. But it would not be three evenly sized players, which might actually be good for competition. Instead, Universal/EMI would be almost as large as Sony and Warner combined. So you could think of this merger as creating one innovation-stifling dominant player, Universal/EMI.

Consider the majors’ current U.S. market shares and what they would be if this merger were to go through.

<table>
<thead>
<tr>
<th>Company</th>
<th>Pre-Merger U.S. Revenue Share</th>
<th>Post-Merger U.S. Revenue Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Universal</td>
<td>31.3%</td>
<td>41.7%</td>
</tr>
<tr>
<td>EMI</td>
<td>10.4%</td>
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</tr>
<tr>
<td>Sony</td>
<td>28.5%</td>
<td>28.5%</td>
</tr>
<tr>
<td>Warner</td>
<td>20.3%</td>
<td>20.3%</td>
</tr>
<tr>
<td>Other</td>
<td>9.4%</td>
<td>9.4%</td>
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</tbody>
</table>

Source: IFPI (based on year-end 2011 data and including contract distribution of independent labels)

Some of the Subcommittee members may note parallels between Universal/EMI and the recently attempted AT&T/T-Mobile merger, which the government successfully sued to block. Had the AT&T/T-Mobile deal gone through, the combined company would have controlled 43% of the wireless revenue in the U.S. Similarly, if the Universal/EMI merger were to go through, that company would control about 42% of the recorded music revenue in the U.S. Significantly though, Universal/EMI would have an even larger share of the most popular music. For example, in 2011, Universal/EMI would have controlled 51 titles of the Billboard Hot 100 – more than half.

Imagine if more than half of the most important prescription drugs made in the U.S. were controlled by one company. Imagine the effect that would have on innovation and pricing in that industry – and what it would mean to consumers. I hasten to add that I recognize the many important distinctions between digital downloads and medicine, but the principles regarding competition in the market are the same.

The potential level of concentration that would result from the proposed Universal/EMI merger has never been seen before in this industry. No record company in the SoundScan era has had a U.S. market share greater than the more than 30% that Universal commands today.

Again, a combined Universal/EMI would have about a 42% U.S. market share. This is high by almost any standard. Consider other industries: General Motors has about a 20% market share. The largest airline – Southwest – has an 18% market share.

The story is the same for the media industries.

To put it in context, last year, the largest movie studio, Paramount, had a market share of around 20%. Random House, the largest trade book publisher, was less than 20%. And Comcast, the largest cable operator, had just over 20% of pay television.

So who would be hurt by this merger, and how?

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7 SoundScan first published market share figures on March 1, 1991.
Universal, currently the world’s largest recorded music company and the world’s largest music publisher, would become the dominant firm in recorded music. It would effectively become a bottleneck. It would impede technological innovation. It would significantly reduce competition among record labels to sign artists. And it would interfere with its competitors’ access to effective distribution with both physical and digital retailers.

There are three key areas I’d like to discuss in which the proposed merger would substantially lessen competition to the detriment of innovation and consumers.

Anti-Competitive Effects: Impact on Innovation, Current Digital Offerings and Price

This proposed deal carries great anti-competitive risk—the obstruction or prevention of digital music innovation, which would reduce consumer choice and impede the development and growth of technology platforms and services. This concern cannot be overemphasized. Apple’s iTunes franchise has been the cornerstone of its content strategy and a key to that company’s ascent to become the world’s most valuable business. Following Apple’s example, music services have become important strategic elements of most major consumer-focused digital companies (e.g., Amazon, AT&T, Facebook, Google, Microsoft, Nokia, RIM, Sony Electronics and Verizon).

Consumers rely on innovation in the music space and adapt to it quickly:

- Today more than 225 million consumers worldwide have an iTunes account;
- In 2011, the number of paid download buyers in the U.S. increased 14% to 45 million customers, and the average annual expenditure for digital music rose 6% to $49;
- Less than a month after launching in the U.S. in the summer of 2011, Spotify had more than 1.4 million users.

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8 Many commentators have noted the importance of music and iTunes in Apple’s success. See, e.g., Douglas A. McIntyre, Why Apple Is Now No. 1 Company in the World (msbc.com, August 10, 2011) available at http://www.msnbc.msn.com/id/44090899/ns/business-us_business/why-apple-now-no-company-world/. In Walter Isaacson’s biography of Apple founder Steve Jobs, several excerpts describe the importance of music to Apple’s overall strategy. Walter Isaacson, Steve Jobs (2011) (examples include: “Jobs launched a new grand strategy that would transform Apple—and with it the entire technology industry. The personal computer…would become a ‘digital hub’ that coordinated a variety of devices, from music players to video recorders to cameras” at 379; “iTunes: It didn’t take Jobs long to realize that music was going to be huge” at 382; “As competitors stumbled and Apple continued to innovate, music became a larger part of Apple’s business. In January 2007 iPod sales were half of Apple’s revenues. The device also added luster to the Apple brand. But an even bigger success was the iTunes Store… It built up a database of 225 million active users by June 2011, which positioned Apple for the next age of digital commerce” at 410).
9 http://www.asymco.com/2011/06/10/getting-to-one-billion-itunes-users/;
Sirius XM Radio has 21.9 million subscribers;\(^\text{12}\) Pandora has 47 million active users and has streamed more than 8.2 billion hours of radio in the year ending January 31, 2012;\(^\text{13}\) and 43% of the U.S. Internet population listened to online radio in 2011.\(^\text{14}\)

Today, a new digital service looking to obtain content for its launch can engage any one of the four major labels initially, and then seek to enter deals with the others. For example, as I mentioned, Warner was first to sign on with Apple’s iTunes in 2002. It was also the first with YouTube (2006) and later with Apple’s cloud service, iTunes Match (2011). Sony was the first to conclude a transaction with Spotify in the U.S. (2011) and EMI was first to cut a deal to sell DRM-free downloads to Amazon and Apple (2007). Once an agreement is in place with one of the major labels and a new digital model has been substantiated with defined contractual terms, the other majors tend to follow one by one.

Record labels typically negotiate comprehensive agreements with digital music services to provide access to the label’s entire catalog of sound recordings. For a major label, these agreements include access to all of the major’s content, as well as, in most cases, the works of those independent labels that the major distributes. An agreement between a major label and a digital music service includes a wide range of provisions, covering areas such as price, term, territory, description of service, consumer data, advances, royalty reporting and product promotion. As part of their negotiations with new digital music services, the major labels often take an active role in shaping the characteristics of the business models and consumer offers under which such services go to market.

In the current environment, once three majors have come on board, the fourth has a difficult time remaining a holdout. For example, in 2002-2003, Sony resisted signing on to iTunes in part because Sony Corp. was concerned about competition between Apple and its consumer electronics business. Under threat of being left behind, Sony eventually came to terms with Apple.\(^\text{15}\)

This “sequential negotiation” paradigm works today because no major is so large that it can effectively block a service from launching by withholding its catalog. A service can reach terms with any of the four majors, and build momentum from there. Once three majors are on board – and a “supermajority” of labels backs the new service – it’s difficult for the fourth to hold out. In the current environment, each of the major labels has “sponsored” various services

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\(^{14}\) [https://www.npr.org/2011/06/03/138035398/](https://www.npr.org/2011/06/03/138035398/)

despite concerns they might be disruptive, and each has been dragged along as the last through the door. Start-up services that can gain the support of three majors usually can get the fourth to go along, either before or shortly after launch.

There are, of course, exceptions. Most notably, Universal has shown a propensity to hold out. Its actions may have led to the bankruptcy of a well-capitalized new service called Beyond Oblivion when Universal failed to license the service, as well as forced the sale to Apple of a service called lala when Universal blocked lala’s proposed integration with Facebook. But the competitive balance that currently exists usually means that a holdout label will eventually agree to provide its content to a digital music service accepted by the other three majors, despite its reservations about the new service. This competitive balance also helps new digital music services resist being forced to accept onerous deal terms from any given major.

But the proposed merger would obliterating this fragile dynamic. It would eliminate EMI from the mix and substantially increase the size of Universal/EMI relative to Sony, Warner and independent record companies. As a result, new music services would have to view Universal/EMI as the barrier to entry. Without obtaining Universal/EMI’s content, a digital service couldn’t gain a supermajority – regardless of which other majors the service had signed up. Universal/EMI alone would determine which services would live or die. It would have the power to unilaterally withhold support from new digital services or to make deals with them only on supra-competitive terms. Controlling access to vital repertoire that no other competitor could provide, Universal/EMI would be able to exercise its blocking position to coerce exclusionary deals and extract higher royalties, advances and other favorable terms by virtue of its market power alone.

Indeed, Universal already may be at the precipice of such power. Universal has reportedly sought to obtain, and may have already succeeded in forcing digital service providers to agree to revenue allocations and/or promotional opportunities disproportionate to Universal’s market share or actual usage share on the particular service.

Here’s how it would work if this merger goes through: Universal says to a digital start-up, “Yes, we will license you. But instead of paying out royalties based on the actual usage of our music (which might approximate our 42% market share), we want our royalties to be paid out as if the actual usage of our music were, say, 50%.” To get into the market, a start-up might actually have to agree to that. However, if the new service is paying out artificially high royalties to Universal, this money will have to come from somewhere. You guessed it – lower royalties for other record labels or higher prices for consumers, or both.

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A telling illustration of how Universal imposes leverage in negotiations with digital distributors, and the resulting impact on contract terms and consumer pricing, is set forth in this account from the *Wall Street Journal*:

“In some cases, Universal has already used its market power to extract favorable terms from online music services. In early 2008, David Pakman, then the CEO of eMusic.com Inc., was negotiating to add major-label releases to his company's catalog of independent music. David Ring, a senior digital executive at Universal Music, told him Universal’s massive catalog entitled it to more favorable terms. He said, ‘We get more, because we’re Universal. That’s just the way we roll.’ Mr. Pakman recalls. That stance, Mr. Pakman adds, applied to ‘every dimension of our contract: the rate you pay per unit sold; the promotion you agree to do.’ The companies reached an agreement 2½ years later, after Mr. Pakman had left and eMusic raised its prices sharply.”

Other examples of disproportionate allocations of revenue and promotion secured by Universal may include: the Nokia “Comes with Music”; RIM “BBM Music”; and Spotify services. According to Helienne Lindvall of UK’s *The Guardian* newspaper:

“Though all deals with Spotify are covered by non-disclosure agreements (NDAs), it is well known in music industry circles that Universal was able to secure a minimum streaming rate for the ad-funded version of the site – something, it is understood, not even the other majors have been able to accomplish. You can’t blame Universal for securing the best deal possible. After all, it has a lot of leverage, being the world’s biggest music group. Spotify would be a lot less successful without Universal artists such as Lady Gaga, Eminem and Black Eyed Peas. I do, however, have an issue with a track by Lady Gaga earning more money for 100,000 streams than, for example, one by Adele or the xx…”

An example of Universal trying to dictate a new service’s business model was evidenced by the 2011 Deezer judgment in a French court. The court rejected Universal’s attempt to prohibit Deezer from using its catalogue of songs finding that Universal was abusing its dominant position by the new terms and conditions it was trying to foist on Deezer.

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19 See “*Tribunal de Grande Instance de Paris Ordonnance de Référé; September 5, 2011: Universal Music France / Blogmusic,*” (Legalis, September 15, 2011); also “*Musique en ligne: Universal Music déboute contre Deezer en
Even if another major label managed to promote innovation by being the first to reach an agreement with a start-up digital service, the post-merger size of Universal/EMI and its disproportionate market share – its status as a “must have” – would give it leverage to drive its own terms, ignoring any precedential effect from previously concluded deals with other majors. There would simply be no credible threat that a service could launch without it. Whatever economic terms might be obtained by another major in exchange for being first to sign on to a new service, Universal/EMI might very well demand and receive a premium on those terms. Anticipating these dynamics, digital music service providers would have little incentive to exert the effort to enter into such early deals with smaller companies in the first place, recognizing that they must eventually go to Universal/EMI to determine what models it would support and how much it would charge to provide its catalog.

This means that Universal/EMI would be able to dictate the business models of new services, in addition to raising the prices it would obtain for its music rights. This power was perhaps foreshadowed by Jean-Bernard Lévy, Chairman of the Management Board of Universal’s parent company, Vivendi, quoted in a Wall Street Journal article published shortly after the Universal/EMI merger was announced:

“Mr. Lévy ruled out trying to create an equivalent to Apple’s iTunes but said that by gaining muscle with the EMI bid, Universal Music would also gain bargaining power in price talks with digital distributors. ‘We hope that in the future we will be less dependent on a certain number of digital platforms which have damaged our position.’”

“Damaged our position” – it is hard to imagine a more telling description of Universal/EMI’s attitude toward innovation and hopes for the future should the merger be allowed to go through. With a truly dominant position, it is easy to envision how Universal/EMI would seek to utilize that market power.

In a recent Reuters article, a Universal spokesman said Universal’s EMI deal would allow the company to increase investment in digital services.29 Imagine consumers getting their music from a digital service owned by Universal/EMI – now, that’s innovation.

New distribution models are emerging all the time. No one can tell where this transformation may ultimately lead us. But if the coming decade is anything like the last, it will continue to be revolutionary. The most recent area of innovation has been in the form of cloud-based “music lockers” and streaming services that provide alternatives to download stores, the first-generation digital platforms. Streaming “jukebox in the sky” services offer a consumer the

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choice of unlimited network access beyond their existing library to millions of music tracks stored in the cloud, typically in exchange for a monthly fee.

Post-merger, Warner would be the largest of the remaining smaller companies (after Universal/EMI and Sony), but it would clearly be unable to constrain Universal/EMI. Warner accounts for about 20% of the U.S. recorded music market. While Warner is unable to effectively hold up the launch of a new digital service today, it can (as the iTunes and many other examples indicate) be a positive moving force. The proposed merger would eliminate the realistic opportunity for Warner, or any other label besides Universal/EMI, to play that role in the future. The proposed merger would leave control of digital innovation in the hands of one company – Universal/EMI – a company that has already proven by its past behavior how disastrous this development would be for the marketplace.

The impact of a merged Universal/EMI, however, would not just be limited to new digital services. Current models and services would be impacted as well. As I've noted, Universal/EMI would be an absolute “must have.” As with physical distribution, which I discuss below, this status would accord it the ability to demand a supra-competitive premium from any existing service in renewal negotiations. Universal/EMI would be in a position to control pricing to the consumer. And it would demand (as Universal has in the past demanded) a disproportionate share of revenue and available promotional inventory (e.g., home-page features, e-mail blasts, pre-order campaigns), which unfairly harms competition.

**Anti-Competitive Effects: Physical Distribution**

The proposed transaction would also significantly strengthen Universal’s position vis-à-vis physical music distributors.

“Brick and mortar” retailers have limited shelf space available for CDs. They need to be able to offer the current hits and top sellers, and they generally place less emphasis on carrying a deep catalog. Universal/EMI would have the following artists on its roster: U2, Coldplay, Maroon 5, Lady Gaga, Katy Perry, Rihanna, Norah Jones, Lady Antebellum, the Rolling Stones, the Beatles, the Beach Boys, Jay-Z and Kanye West, among many others. Can you imagine trying to say “no” to them?

Post-merger, Universal/EMI’s strong position in chart hits (i.e., 51 of the titles on the Billboard Hot 100 chart and 45% of SoundScan’s Top Seller album category in 2011) would mean that it would be in position to call the shots on physical distribution. It would dictate terms to retailers, including key price and promotional terms. This would inhibit competition from

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21 While digital retailers have the virtual space to carry deep catalogs (and usually do), it is the top hits that drive a substantial portion of the revenue.
rivals, reduce choice and potentially increase costs to consumers. For example, Universal/EMI would be able to require more “end cap” or other high-traffic space or demand more in-store promotions, all the while offering less promotional support to the retailer. It would be able to unfairly condition retailers’ access to must-have superstars in exchange for favored placement of Universal/EMI’s breaking acts. This would have the effect, directly or indirectly, of limiting opportunities available to Universal/EMI’s competitors, thus increasing their costs of distribution.

Universal itself argued in 2000 that a major recorded music firm with shares in the 40-50% range would be able “to behave independently of its competitors and thereby increase barriers to new market entry, and prevent, restrict or distort competition.” There is no reason to doubt the truth of this statement today.

**Anti-Competitive Effects: Impact on Artists**

The Universal/EMI merger would meaningfully reduce competition for artists seeking to sign with a major record label. As a music executive, I’ve seen plenty of bidding wars to sign artists. And I can tell you from experience that when there are more labels out there looking for – and competing for – artists, we, as an industry, have not only discovered more artists overall, but they’ve also been better compensated because of that competition. There is no question that there would be less of that if this deal is completed. And it would be even more difficult for rising artists to successfully break into the industry were this merger to be completed.

Moreover, the competition to sign certain artists is often currently more directly between Universal and EMI than with the other two majors, Sony and Warner. Post-merger, those artists would lose EMI as an independent bidding option. One notable example is that of Katy Perry, who was dropped by Universal but who found a home (and enormous success) with EMI.

I’ve heard people say that this merger doesn’t matter to artists because they can simply market and distribute themselves online. But as I’ve said in the past, and will say again: an agreement with a major label is critical for an artist who wishes to succeed in the U.S. One of the central reasons for this is that, even today, the most important way for an artist to gain exposure with the record-buying public is radio play, which is virtually out of reach to artists not signed or distributed by a major. In 2011, according to Mediabase, 10 record labels owned by

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22 It also bears noting that at the time of Universal’s comments there were five rather than four major record companies. BMG’s recorded music business merged with Sony in 2004, again over Universal’s strong objection.  
23 See, e.g., Katherine Rushton, “Adele’s Record Label Attacks Universal-EMI Deal;” (The Telegraph (U.K.), April 14, 2012) (noting that Universal’s proposed bid to buy the recorded music division of EMI risked creating a “lowest common denominator music market,” because it would end up depriving niche artists of the retail space and publicity they need to become successful), available at [http://www.telegraph.co.uk/finance/newssector/mediatechnologyandtelecoms/media/9204857/Adeles-record-label-attacks-Universal-EMI-deal.html](http://www.telegraph.co.uk/finance/newssector/mediatechnologyandtelecoms/media/9204857/Adeles-record-label-attacks-Universal-EMI-deal.html).
the majors accounted for 92% of total U.S. airplay. And while it may be theoretically true that any artist can gain access to the market through the Internet, the reality is that sales on iTunes are hit-driven so are even more skewed towards chart hits. There’s a common rule of thumb in business that 80% of sales often come from the top 20% of inventory; our experience with U.S. single-track download sales is that roughly 95% of the revenue comes from 5% of the tracks. With tens of millions of songs available online, music discovery can be a “needle in the haystack” endeavor for consumers, making the marketing strength of major labels more important than ever for artists.

Members of the Subcommittee, we are at a crossroads in the record business.

We face two visions of the future. In the first, we see a world where consumers can get all the music they could possibly want, any way and anywhere they want it and at an affordable price. A world where artists have options among the labels with whom they’d choose to work and where record companies vigorously compete to sign those artists. A world where a person with a transformative idea for a digital music service or product can bring it to market under fair terms. And finally, a world where companies like Warner and independent labels can compete to bring together consumers, artists and digital innovators.

But we also face a second vision: a darker one. A world where fewer artists are signed. Where those who are signed are paid less. Where independent labels and artists are struggling even more to get radio airplay and marketing exposure. Where one company—Universal/EMI—sets the prices, terms and conditions for future digital evolution. Where Universal/EMI would stand as gatekeeper between consumers and what they want, throttling innovation and extracting a heavy toll every step of the way.

We have a choice between these two visions. We understand that the FTC will be the ultimate judge as it determines whether it will sue to block this merger. However, your voice has always been influential as guardians of the public interest and trust.

Clearly, Citigroup—EMI’s current owner—was concerned about the regulatory prospects for this transaction. In a highly unusual contract provision, Universal agreed to pay £1.1 billion—almost the entire £1.2 billion purchase price—whether or not this deal is approved by the FTC. As a frame of reference, that would be as if the $39 billion AT&T/T-Mobile deal had a $36 billion break-up fee.

This sort of arrangement may be legal but it is clearly bad as a matter of public policy. Both parties to any merger transaction should take antitrust concerns seriously and allocate the risk appropriately. When one party—in this case, Citigroup—can shift all the risk and when another party—in this case, Universal—can boldly accept it, it creates a perverse incentive for companies to make deals counter to the public interest and dare us to try to stop them.
Well, I, for one, hope we try to stop them.

A broad and diverse group ranging from consumers to artists to digital start-ups, innovators and record companies alike have all expressed opposition to this merger because we have a vision for a vibrant future for music fans. We urge this Subcommittee to do what it can to prevent this merger from being consummated and make this vision possible.

Thank you. I'd be pleased to answer your questions.
June 14, 2012

The Honorable Herb Kohl
United States Senate
Room 330 Hart Building
Washington, DC 20510

Dear Senator:

We're an indie rock band from Los Angeles. We just released an album, called "Pressure & Time," working with Earache Records, an independent record label. Previously, we self-released our debut album, entitled "Before the Fire."

We've read about how two major labels, Universal Music Group and EMI, want to combine. Several people have asked us what we, as independent artists, thought about it.

We love our label and nothing about the support and expertise they give us will change if there is one less major label in the world, or if a combined EMI and Universal Music Group has a bigger "share" of the market. Rival Sons, Earache Records - or any self-released artist - is hardly threatened by a healthy major label. If combining those two companies means that EMI can survive (and it sounds like they could use some help in that regard), then it's a good thing. Not just for EMI, but for the industry overall.

Today, an artist doesn't need a label to find a fan base (we're proof of that). Any artist with an internet connection can enter the music marketplace. Music is more diverse and accessible than ever before, and no major label, regardless of their size, can ever put that genie back in the bottle.

We appreciate the chance to share our view.


Cc:  Ranking Member Mike Lee
June 15, 2012

The Honorable Herb Kohl
Chairman
Antitrust Subcommittee
United States Senate
330 Hart Senate Office Building
Washington, DC 20510

Dear Senator Kohl,

I recently read that you will be holding a hearing in the near future on Universal Music Group’s planned union with EMI. I don’t object to the combination of the two and wanted to share my reasoning with you.

Today, you don’t need to be discovered by a record label A&R executive, you just need some hits on your self-made youtube video. Forget a studio – just open your laptop and fire up garage band or Pro Tools. Make an impassioned pitch on Kickstarter to get some financial backing. Or hook up with Band Camp, Reverb Nation, Top Spin, ingrooves or any of dozens of other services that can get your music to the masses without a label.

Many of our fans first heard us on an 8 track cassette. Today’s next “it” band can be heard via an ad-supported stream, subscription service, download store, ring tone, Pandora, Slacker, rdio, Spotify, Rhapsody, last.fm, satellite radio... no matter where you are or what you’re doing, you’re almost always a mere click away from music.

These changes are nothing short of incredible. It’s created all kinds of new opportunities for artists, fans, digital start-ups – everyone. Independent labels today have market shares that surpass major label imprints, and artists like Amanda Palmer can raise seven-figure advances without a label at all.

REO Speedwagon spent much of our history with a major label (Epic, part of the Sony Music Group). Having lived through the so-called “height” of the music business at the end of the last century, it’s clear to me how much of the major labels’ power has been eroded over the last decade. Even a combined Universal/EMI will be far less dominant than major labels were a decade or two ago when they had far smaller market shares and FM radio was the only “music service” game in town.

I greatly appreciate your consideration of my views.

Kevin Cronin
REO Speedwagon
WRITTEN SUBMISSION
BEFORE THE SENATE COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND
CONSUMER RIGHTS

ROGER FAXON
CHIEF EXECUTIVE, EMI GROUP
JUNE 21, 2012

Thank you Mr. Chairman, Members of the Subcommittee:

I am Roger Faxon, Chief Executive of the EMI Group. I am pleased to have
this opportunity to speak before you today in regard to Universal Music Group's
proposed acquisition of the recorded music division of EMI.

To appreciate the competitive implications of the transaction we are
discussing today, it is important to place it in the context of the market for recorded
music as it is today, and not as it may have been in the past. In the nearly twenty
years I have been in this industry I can say without a doubt that the music
landscape has changed beyond all recognition.

When I joined EMI in 1994, U.S. retail sales of recorded music were in
excess of $12 billion. At its peak a few years later, that figure was almost $15
billion. Today they are less than half that – just $7 billion - and that includes not
just revenue from the sale of CDs, but digital revenues as well. The forces that
have produced this decline have fundamentally and permanently changed the
dynamics of the music industry. It is my view that those changes have contributed
to a substantial shift in the impact of record company consolidation, on both
consumers and the wider music business. I would like to take the next few minutes to walk you through why I believe that to be the case.

Much has been said about the effects of the digital revolution on our industry. Technology, and most especially, internet technology has engendered fundamental change in consumer behavior. Simply put, the digital revolution has empowered consumers. They are in control. If consumers cannot access what they want, when they want it, the way they want it, at the price they want it through existing legal channels, then many consumers will do so through illegitimate channels. And in the early part of the last decade, they did so in unfathomable numbers. This wreaked havoc on the physical market for music, and changed for all time the position of all record companies - and most particularly for this discussion, the major record companies.

One of the most direct effects of the digital revolution was a precipitous drop in sales of the CD. The backbone of the recorded music industry had always been the specialist music retailer, offering fans a full range of music in every mall and main street in America. Today, those retailers are all but extinct. One of the most direct effects of the digital revolution was a precipitous drop in sales of the CD. The backbone of the recorded music industry had always been the specialist music retailer, offering fans a full range of music in every mall and main street in America. Today, those retailers are all but extinct.
The retail market for music has consolidated and changed out of all recognition. Led by three giant retailers, for the vast majority of these retailers music is not central to their offering. But they are central to record companies and the careers of their artists. To put a point to it, for our top three retail customers in the US, music represents less than half of one per cent of their combined domestic turnover. So it is not hard to understand that it is they – not the record companies – that control the dynamic of the relationship.

In this consolidated retail environment, an album’s presence in Walmart or Best Buy or Target can significantly impact the success of an individual project – and therefore an artist’s entire career. With an ever-shrinking shelf space being dedicated to music, it is the retailers that decide which albums that they will stock, and it is they who can dictate the commercial terms. The evidence on that point is pretty clear. In EMI’s case, we have seen a steady and unrelenting decline in our average wholesale price for CD’s, and I suspect that is not very different for others.

Retail concentration is even more pronounced on digital platforms. Apple’s iTunes is by far the leading digital retailer, by some accounts representing around 80% of download sales. Add in Amazon, the next largest digital service, and you have two players accounting for 90% of sales, and 80% of total digital revenues. In this environment, pricing again does not sit within the gift of the record companies, regardless of size or market position.
What also needs to be understood about the digital environment is that where once access was limited by shelf space in stores, now there is infinite access to consumers through digital services. There is no limit to the amount of music that can be stocked, and so any band, budding artist or independent label can have their music distributed on digital platforms. Major record companies, if they ever were, are no longer the gatekeepers.

In essence, digital distribution has created a music meritocracy. Nowhere is that more amply demonstrated than with the streaming platforms such as Spotify, where consumers decide on every track they play and every creator gets paid broadly the same for every click. Good music quickly rises to the top. The skill is in finding that music, and helping to connect it with an audience - and that skill is not confined to one company or group of companies.

The internet not only has democratized distribution and access; it also has democratized the promotion of that music. The explosion in social media over recent years has taken promotional power from the hands of a few magazine editors and radio station program directors, and put it firmly in the hands of the music fan themselves. Facebook, Twitter, MySpace, YouTube and a myriad of other websites and services are essential in building a buzz about an artist, and play a significant role in their ultimate success. The people writing and interacting about music on these platforms don't have the slightest interest in the market position of
an artist’s record company – they care about the music, and whether it’s any good or not. Radio remains a vital medium in the promotion of artists, but as media has fragmented, so radio stations have become much more focused on playing only the music that their extensive callout research tells them will connect with the highest possible audience. Again, it’s the music that matters, not the source of that music.

As a result, I would argue that competition between music companies – even in the light of some consolidation in the last twenty years – is fiercer than ever when it comes to signing artists that have the ability to connect with an audience. Technology has significantly reduced the cost of entry for new music companies, and more and more people are making use of the internet to create a direct path to market for themselves. You may, for instance, have heard of the musician Amanda Palmer who last month raised almost $1.2 million direct from fans via the crowdfunding site Kickstarter, to self release her new album. More and more businesses are dipping their toes into the music representation and distribution business, and I would say that the music market is more crowded and fragmented than it has ever been. You do not have to be big to enter the market and reach consumers – you just have to have the ability to find great music, and to reach through the clutter to excite fans with it.

So, record companies can’t control consumer pricing, don’t control access to consumers, can’t exert control over promotional platforms or the myriad of music
discovery tools that fans use today, and they're having to compete with the vastly increased number of alternative paths to market for budding or even established artists. If there ever were antitrust issues implicated by label consolidation, it seems to me that on this basis, they are not present today.

Truly over the last decade and a half the music industry has been transformed. Our focus has returned to where it ought to be – on helping artist develop the most compelling music and working with them to ignite passion for it in their fans. And I think we are doing a very good job of that.

But we have another major job and that is to assure that the creators of that music are properly rewarded for their contribution. And sadly, I would say we are not doing as well as we should be in that area. For me, that is because of the erosion of the protection that creators have for their works and what seems to be the promulgation of an ethic that puts individual creators at the bottom of the cultural food chain.

The ambiguity and unenforceability of our intellectual property laws is clearly failing our creators. Individual rights holders are no longer able to protect their music, ISPs are not held responsible for their actions, and safe harbor provisions designed to encourage innovation are instead being used as a shield by bad actors seeking to build their business without appropriately compensating the artists and writers whose music underpins it.
Artists need to be professionals if they are to be successful. Chart-topping songs rarely are created by amateurs in their bedrooms. Hit tracks invariably come from people who have worked at their art for years. These creators need to be paid to do what they do. And that is vastly more difficult with industry revenues down by more than 50% over a little more than a decade, Songwriters, performing artists and those who help them create their music, studio engineers, session musicians, graphic designers and many, many more – have all been significantly impacted by piracy and copyright erosion over these last years.

Technological innovation and musical innovation are not mutually exclusive. Content created by great artists and songwriters can drive consumers towards new ventures, and exciting new platforms and products can enable the opening up of a wider market for the work of creators. But our institutions have allowed the balance to shift too far in favor of big technology.

The impact on our creative community has been devastating, and will only get worse if the scales continue to tip unchecked.

Music is at the beating heart of this nation. This is the country that gave birth to the blues, jazz, rock’n’roll, country, soul, and hip-hop; that produced Miles Davis, Frank Sinatra, Elvis Presley, Bob Dylan, Joni Mitchell, Marvin Gaye, Aretha Franklin, Prince, Beyonce and Kanye West. It’s the country whose music inspires countless young people to pick up an instrument and play, or to open their
mounds and sing. America's musical contribution to the world is without parallel, and is something that every one of us can be proud of.

But with that legacy comes responsibility. We have to support our creators, and give individual artists the ability to protect their works in the way that they see fit – whether that's selling CDs at the back of 300 gigs a year, or working with a major label, or giving away their works on the internet. I don't mind which route an artist takes – I just believe that they should be afforded the right to choose what they do with the music they work so hard to create. Right now, that choice is too often being taken away from them.

For those of us who work with artists whether we are labels both large and small or managers and advisors we have a responsibility to insure that each of those artists has the greatest possible opportunity to succeed. That has to be our overriding goal. To do otherwise strikes at the very foundation of our industry. Universal has an enviable track record in delivering success for its artists, and I am confident that it will be as ardent an advocate for the artists that we at EMI are so privileged to represent.

But delivering success requires more than just selling records. Creativity – and especially music – touches people in a way that nothing else can, and after all this time in the industry, it still remains for me personally, an absolute privilege to be able to represent some of the greatest artists that this world has ever seen. Yet
without a solid framework of intellectual property rights to underpin that creativity, we don’t just threaten labels or jobs, but the ability of this country to nurture the next Jay-Z, the next Beach Boys, the next Norah Jones. That won’t be the fault of any merger or acquisition – it will be the fault of our own inertia, and an unwillingness to stand up to protect one of the greatest cultural strengths this country has to offer and the economic contribution it makes.

Thank you.
UMG-EMI Deal Is No Threat To Innovation In Music Distribution

By Geoffrey Manne and Berin Szoka

Everyone loves to hate record labels. For years, copyright-bashers have ranted about the “Big Labels” trying to thwart new models for distributing music in terms that would make JFK assassination conspiracy theorists blush. Now they’ve turned their sites on the pending merger between Universal Music Group and EMI, insisting the deal would be bad for consumers. There’s even a Senate Antitrust Subcommittee hearing tomorrow, led by Senator Herb “Big is Bad” Kohl.

But this is a merger users of Spotify, Apple’s iTunes and the wide range of other digital services ought to love. UMG has done more than any other label to support the growth of such services, cutting licensing deals with hundreds of distribution outlets—often well before other labels. Piracy has been a significant concern for the industry, and UMG seems to recognize that only “easy” can compete with “free.” The company has embraced the reality that music distribution paradigms are changing rapidly to keep up with consumer demand. So why are groups like Public Knowledge opposing the merger?

Critics contend that the merger will elevate UMG’s already substantial market share and “give it the power to distort or even determine the fate of digital distribution models.” For these critics, the only record labels that matter are the four majors, and four is simply better than three. But this assessment hews to the outmoded, “big is bad” structural analysis that has been consistently demolished by economists since the 1970s. Instead, the relevant touchstone for all merger analysis is whether the merger would give the merged firm a new incentive and ability to engage in anticompetitive conduct. But there’s nothing UMG can do with EMI’s catalogue under its control that it can’t already do. If anything, UMG’s ownership of EMI should accelerate the availability of digitally distributed music.

To see why this is so, consider what digital distributors—whether of the pay-as-you-go, iTunes type, or the all-you-can-eat, Spotify type—most want: Access to as much music as possible on terms on par with those of other distribution channels. For the all-you-can-eat distributors this is a sine qua non: their business models depend on being able to distribute as close as possible to all the music every potential customer could want. But given UMG’s current catalogue, it already has the ability, if it wanted to exercise it, to extract monopoly profits from these distributors, as they simply can’t offer a viable product without UMG’s catalogue.

The merger with EMI—the smallest of the four major labels, with a US market share of around 9%—does nothing to increase UMG’s incentive or ability to extract monopoly rents. UMG’s ability to raise prices on Lady Gaga’s music is hardly affected by the fact that it might also own Lady Antebellum’s music, any more than its current ownership of Ladyhawke’s music does. But, regardless, UMG has viewed digital distribution as a friend, not a foe.
Even on their own, structural terms, the critics’ analysis is flawed. The argument against the merger is based largely on the notion that the critical, relevant antitrust market comprises album sales by the four major labels. But this makes no sense.

In fact, UMG currently distributes only about 30% of the music consumed in the US, and because, like all the majors, it distributes some music over which it has no ownership rights (including no ability to set prices), it owns only 24% of music purchased in the US. EMI’s share of distribution, as we noted, is around 9%, and it has experienced significant turmoil in recent years. Meanwhile, the independent labels that some critics seek to exclude from the market (and which, ironically, probably distribute the bulk of the music they listen to) sell 30% of the records sold in the US today and do so digitally largely through a single distributor, Merlin—essentially a fifth major record label. This is far beyond trivial.

What matters for antitrust market definition is substitutability: If customers would purchase eight singles off an album in response to an increase in the 12-track album price, singles and albums are surely in the same market. Ditto consumption of singles and entire albums through streaming services in lieu of outright purchase—and it’s clear that this mode of distribution is increasingly popular. There is no principled defense of an album-only market, nor one that excludes independent labels or streaming services. And once you appreciate these market dynamics, the concerns over this merger disappear.

The reality is closer to this: EMI is effectively a failing firm. Its current owner (Citigroup) inherited the company when its previous owner defaulted, and it promptly put it up for auction. Warner and UMG both bid on EMI and UMG won. Now Warner leads the effort to stymie the deal, deploying a time-tested strategy of trying to accomplish by regulation what it couldn’t manage through genuine competition.

Critics worry that a larger UMG will stifle innovative distribution services. While that’s theoretically possible, UMG’s past practice and the industry’s changing dynamics—including the significant increase in buyer power from large retailers like Apple, Amazon and Wal-Mart—suggest the concern is speculative, at best. Albums are simply not the dominant marketing vehicles they once were for most artists, and, increasingly, consumers are content to “rent” their music through streaming and other online services rather than own it outright.

A slightly larger UMG poses no threat to the evolving distribution of music. In fact, UMG has increasingly championed digital distribution as it has grown in size. UMG’s history with digital distribution should please anyone concerned about the deal: it has been both aggressive and progressive in the digital space. UMG is often the first to license its catalogue to new services and it has financially supported the creation of some of the largest of these services. When online giant Slacker Radio added a subscription service to its Web radio offering, UMG not only licensed its catalogue for the new service but also renegotiated (and lowered) its terms for Slacker’s webcasting license in order to ease Slacker’s move into subscription services. And
UMG was instrumental in getting Muve—the second largest subscription music service in the US today—off the ground. Again—the industry’s best defense against “free” is “easy,” and that doesn’t change for UMG if it gains another few percentage points of market share.

To paraphrase Timbuk 3 (from an album originally released on the famed I.R.S. label): Music’s future is so bright, it’s gotta wear shades. Music has never been cheaper, easier to access, more widely distributed, nor available in more forms and formats. And the digital distribution of music—significantly facilitated by UMG—shows no signs of slowing down. What has slowed down, thanks largely to these advances in digital and online distribution, is music piracy.

Anyone looking for an explanation why UMG has been so progressive in its support for innovation in music distribution need look no further than that fact. This merger does nothing to change UMG’s critical incentives to continue to support digital distribution of its catalogue: fighting piracy and effectively distributing its music.

WRITTEN SUBMISSION OF UNIVERSAL MUSIC GROUP
BEFORE THE SENATE COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND
CONSUMER RIGHTS

LUCIAN GRAINGE, CBE
CHAIRMAN & CEO
JUNE 21, 2012

Mr. Chairman, Ranking Member Lee, and Members of the Subcommittee,
thank you for the opportunity to appear here today. My name is Lucian Grainge,
and I am the Chairman and CEO of Universal Music Group. We at Universal are
pleased to assist the Subcommittee by testifying about our pending acquisition of
EMI’s recording music business. We appreciate the opportunity to share our
vision for combining EMI’s rich heritage with Universal’s track record of investing
in the future of music. Our coming together will benefit consumers, artists, and all
those committed to a diverse and healthy music business.

Over the course of my 33 years in this business, I signed many talented
songwriters and artists. I have worked with great bands that never became
household names, as well as stars such as U2, Elton John, ABBA, Eurythmics,
Paul Anka, Rihanna, Mika, Duffy, and Amy Winehouse. I still consider myself a
talent scout today, but now my talent search has expanded to include writers,
producers, sound engineers, creative executives, start ups, entrepreneurs, and
digital platforms.
The music business has changed dramatically, as the Judiciary Committee is well aware. You have studied and assessed the challenges presented by the Internet, and I appreciate the many actions that you have taken to bolster and support businesses that depend on the protection of intellectual property. Many of the basic principals of law that have been acknowledged and protected by the Judiciary Committee have enabled us to invest in innovative artists that connect with audiences around the globe.

The future of the music industry depends on new ideas, new business partnerships, and of course, the development of new artistic talent. This industry will always change and redefine itself. But one thing will remain constant – the demand for great music. I look forward to reinvigorating EMI’s labels with Universal’s resources, expertise, and innovation, so that EMI can continue its tradition of discovering, producing, and sharing with the world some of the greatest music of our time.

**Universal Is Committed To Innovation And Embracing Wide Distribution**

The future success of the music industry is going to depend on the distribution of music through as many platforms as possible. Universal is committed to investing and innovating to meet the competitive challenges of the digital age – which means providing consumers what they want, when they want it, and how they want it.
The challenges to the music industry are significant. Extensive piracy has curtailed sales, resulting in lost profits and significant pricing pressure. Over the past decade, the recording industry in the United States has been almost cut in half — from about $13 billion in 2002 to $6.5 billion last year. This lost revenue has caused a great many people to lose their jobs and has limited the resources available to enable aspiring artists to pursue their dreams.

We have responded to these challenges by embracing distribution via the broad range of emerging technologies. Universal has a strong record of embracing ground-breaking innovations to market artists and recorded works through multiple channels. It is not at all unusual for us to distribute a single album in numerous digital formats — from singles, to albums, to ringtones, to videos, to remix tracks, to greeting cards, to DVDs, to TV shows, to advertising, and more. In order to sell music and support our artists, Universal must get the music to the consumer, whenever and however consumers are looking for it. Universal has learned that we need as many lines going to as many shores as possible.

With our commitment to embracing digital platforms and new opportunities, our revenues leveled off between 2010 and 2011. That is not the same as growth — but after a decade of significant decline, it’s a start. Universal is committed to working with our technology partners and innovators so that we can
succeed in this fiercely competitive and dynamic market, empower our artists, and provide consumers with high quality, diverse, creative music.

**Universal’s Resources, Expertise, And Innovation Will Reinvigorate EMI**

EMI has a storied history – it has brought the world some of the greatest artists in history – from the Beatles to Frank Sinatra. It is built on the foundations of the creative hubs at Capitol Records and its associated studios here in the US and, of course, the EMI UK labels and the incredible Abbey Road studios. Yet, the past decade has been undeniably difficult for EMI. EMI is currently owned by Citigroup, which acquired EMI following a default by EMI’s previous owner, a private equity group. During this time, its owners have significantly reduced EMI’s ability to invest in the search for new artists and innovative sounds. The team at EMI have done a masterful job under trying circumstances – and with the right financial support, long term commitment, and stability, they can contribute mightily to the global music scene.

With Universal’s infusion of resources and commitment to investing in artistic development, there will be a healthy future for the company. We are absolutely committed to investing in EMI as a distinct business that can help us develop even more music and more choice for consumers and fans everywhere. EMI’s labels will be reinvigorated and artists will have more choices, which will lead to more competition in this dynamic market.
Furthermore, Universal will bring its expertise in distribution through multiple channels to EMI. Universal has built a strong record of selling, licensing and distributing music widely. Universal has 123 active digital music deals in place in the United States right now. Universal’s expertise will add value to EMI’s current and catalogue recorded music assets, fostering the development, expansion, and marketing of EMI’s assets to their full potential.

The Music Industry Is An Increasingly Competitive, Dynamic Market

Universal and EMI are both committed to music – committed to our artists and committed to the exploration and development of new sounds.

To Succeed In Today’s Marketplace, Universal And EMI Must Embrace And Nurture The Broad Range Of Continuously Developing Platforms Consumers Demand

On June 6, 2012, the Chairman and CEO of the Recording Industry Association of America testified before the House Committee on Energy and Commerce and said:

We often hear the complaint that we need to get a new business model. Well . . . our companies have done just that:

- You want DRM-free downloads? We’ve got that: iTunes, AmazonMP3, eMusic, 7digital.

- You want to pay a modest monthly fee for all the music you can ever listen to – on your computer or smart phone? We’ve got that: Rhapsody, Spotify, MOG, Rdio, Music Unlimited, rara.com, Zune Music Pass.
You want free, ad-supported video and audio streaming? We've got that: Spotify, YouTube, Vevo, Myspace Music, AOLMusic.

You want music bundled with your mobile phone? We've got that: Muve Music, Metro PCS/Rhapsody

You want to store all your music in the cloud, so you can access it from wherever you might be? We've got that: iTunes Match, and more deals in the works.

You want specialized digital radio services that offer you the niche kind of music you like to hear? We've got that: Pandora, SiriusXM, Last.fm, Yahoo!Music, AOLMusic, and over 750 more such services.

You want online simulcasts of AM/FM radio stations? That is available too: iHeartRadio, WJLK-FM 99.3 (The Point), KPWR-FM (Power 106), WXLC-FM (102.3 XLC), and over 750 more online radio stations . . .

There are over 500 digital services authorized by our member companies worldwide offering 20 million authorized tracks. ALL of these business models have been embraced and authorized by major and independent music companies.¹

The range of digital services is increasingly complex. No two services are exactly the same, which is a good thing, because these services expand the range of choices for artists and consumers.

In order to compete in a world where music is readily, if illegally, available for free, we know that our future is contingent on the vitality of legitimate digital services. This, in turn, is contingent on the work of the Recording Industry Association of America and other organizations that keep digital content secure.

music services. In 2011, for the first time ever, the industry-wide revenue from
digital sales was nearly equal to the industry’s revenue from physical sales. This
year, the industry’s revenue from digital sales likely will exceed revenue from
physical sales for the first time. Universal has already made this switch. In 2011,
Universal’s overall revenue from digital sales (including tracks, albums, streaming,
and other services) was already 27% greater than its revenue from physical sales.

Our mission is to give consumers what they want, when and how they want
it. Because fans want their music instantly, they can enjoy downloads from
iTunes. Because fans want music on the go, we give them that through cloud
services like GoogleMusic. And indeed, because fans want their music to feel free,
they can get that too through advertising models like Spotify and YouTube.

It is in Universal’s interest to engage with the broad range of new
distribution channels available to consumers. We need robust, vibrant, and
successful legitimate music services in order to compete with pirate sites that carry
substitutes of our artists’ works. We want a large number of innovative digital
music services to flourish. We are not a tech company, but our viability is
contingent on the success of legitimate online and mobile music services and
digital models.

I have seen this industry transition from eight-track tape to instantaneous
download onto smart phones. I know that I cannot predict which platforms
consumers will demand, but I can predict that consumers will continue to demand their music on new and evolving platforms and, as our track record demonstrates, Universal’s catalog and repertoire will be on those services.

Consumers Demand That Diverse, Comprehensive Catalogs Are Available On The Music Service Of Their Choice

We already have countless “must have” songs – whether it is the Motown collection or Elton John or U2. And we embrace, as we must, a market strategy of wide distribution. We will have the same strong incentives to distribute EMI’s catalog. We sign hundreds of new distribution deals every year, and we are willing to talk with any viable new service with a credible business plan. Every Universal employee knows that we must continue selling, licensing, and distributing music widely on a non-exclusive basis if we are to harness the power of the Internet age and empower our artists to reach an audience. We owe that to our artists, we owe that to their fans, we owe that to our shareholders – it is our recipe for success.

The Universal/EMI Deal Will Expand The Options Available To Artists

Universal is committed to expanding the options available to artists and growing the music industry.
Artists And Musicians’ Unions Support The Universal/EMI Deal

As recognized by the unions that represent America’s recording artists, professional musicians, and other entertainment and media industry professionals, Universal is committed to its artists and respects industry collective bargaining agreements. These unions agree that Universal will be able to reinvigorate EMI and position it for the future.

SAG-AFTRA’s Kim Roberts Hedgpeth expressly stated that Universal has “best weathered” the “daunting and unprecedented challenges” of the past decade “by maintaining its commitment to the art and the music industry, and by investing in new artists and innovative musical genres.” She also concluded that, “[f]rom a labor perspective, UMG’s compliance with and respect for its collective bargaining agreements and relationships has been unique among recording companies. As such, sustaining the EMI legacy under UMG’s oversight appears to be a benefit to SAG-AFTRA’s recording artist members.”

American Federation of Musicians’ Ray Hair has also recognized our commitment to artists and to ensuring that they receive their due compensation through our industry-leading compliance with collective bargaining agreements. We also value AFM’s observation that recording musicians will benefit from

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Universal’s oversight of EMI’s legacy and its future. Universal looks forward to providing the same levels of respect to EMI’s artists to further support their musical success.

*Artists Have Choices*

We are not just competing against the other major labels, Sony and Warner, who are already vigorous competitors. We compete with the significant “Indie” market, which, according to A2IM, the Indie trade association, represents over 30% of the market in the US. Indeed, the global rights agency Merlin, which represents independent music rights, refers to itself as the “the virtual fifth major.” And we compete with DIY (do-it-yourself) artists, who can record, promote, and sell their own music.

Smaller labels have agreed that the Universal/EMI deal will not limit their success. Scott Borchetta, chief executive of Big Machine Records, has said that consolidation does not matter as much in the digital age. “When the major labels

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3 Letter from Raymond M. Hair, Jr., International President, American Federation of Musicians of the United States and Canada, to the Honorable Jon Leibowitz, Chairman, Federal Trade Commission, dated April 10, 2012.


5 Merlin’s mission is “to ensure its members have effective access to new and emerging revenue streams and that their rights are appropriately valued and protected.” It holds itself out as “the most efficient means for digital music services to license repertoire from the largest and most compelling basket of independent rights in the world.” Merlin, “Welcome to Merlin,” available at http://www.merlinnetwork.org/home/.
controlled the distribution channels, it was a different deal, but now the barrier to entry is literally turning on your computer," he said. "If I continue to make great records by great artists, nobody can stop us."

Mike Chadwick, an experienced UK Indie label and distribution expert, has said that the Universal/EMI deal is “great” for the Indie market:

Is it good for us? It’s great for us: there are loads of middle-level artists who are perfect for us. If we sell 10,000 records, I’m happy – we don’t have to sell a million records to make a profit. Artists who are unhappy gravitate towards companies like us. These huge amalgamations or mergers are really good for the indies.

The Indie labels are strong competitors in the age of digital distribution.

Furthermore, technological advances mean that neither a “major” label deal nor an “Indie” label deal are essential for an artist. As David Pogue, the New York Times technology columnist, wrote in the May 9, 2012 New York Times, “In the online world, you can take your music straight to the public. No more gatekeepers, record executives or rejection letters. If you’re any good, you’ll soon win your fame and fortune — or at least sky-high view counts.”

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Mr. Pogue was referring to DIY (do it yourself) products that offer artists key services – services that had traditionally been offered only by record labels. This is a dynamic, competitive market where artists can choose their own path to success.

**Universal's Plan Going Forward**

We are in a world of the unknown in an unpredictable, dynamic industry. With such revolutionary distribution channels developing all the time, the music industry is constantly changing and ever more competitive. Everything we thought we knew about the music business is changing – but that can be said about music itself. And that is why I love it. Universal/EMI will continue to promote artists, invest in the future of the industry, and explore new business models in as many sales outlets as possible – digital, streaming/subscription, ad-based, DVDs/CDs – and whatever other outlets I hope are currently being developed.

Through our acquisition of EMI, Universal will enhance the creative investment in the company and further broaden the support for digital services. This will provide more opportunities for artists and more music and choice for consumers than ever before.

Thank you for the opportunity to speak with you today. I look forward to your questions.
Re: Universal-EMI merger

Dear Sirs,

On behalf of the International Federation of Musicians and its 68 member organisations, I would like to submit some brief comments in relation to the proposed merger in reference, which is currently under investigation by the U.S. Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights.

As they are today, the four major record companies already represent a high market concentration. For performers, this situation means weak bargaining power and hyper-standardised, disadvantageous contracts. An increased concentration of the market forces into a duopoly can only be expected to worsen this already unbalanced situation.

The artists’ bargaining power has continued to decline over the past 5-10 years. Rights transfers in contracts are usually all-inclusive and irrevocable. Even the remunerations that are granted to performers by law (for example for public performance of phonograms) through collecting societies must be transferred to record companies on paper, "just in case" any future legislation allows them to take this money from the performers.

The problems that artists have been facing in the traditional market for many years are even worsening in the digital world, from which they usually receive insignificant incomes. Should the merger be authorised, artists would lose one of the remaining four alternative routes to access the mass market.

The dominant position of the remaining two major record companies against copyright societies would also be reinforced. Singer-songwriters and other author-performers would be required to contract with the publishing arm of these companies.

According to our members’ experience of similar mergers in the past, the new duopoly would also mean less investment, lower quality, fewer jobs, narrowed consumer choice as well as reduced cultural diversity.

For all the reasons above, we believe that the merger in reference should not be authorised.

I thank you in advance for your kind consideration and remain at your disposal for any further comment you may require.

Yours Sincerely,

Benoit Mactuel
General Secretary

The International Federation of Musicians (FIM) is a non-governmental organization representing musicians' unions, guilds and associations in about 65 countries covering all regions of the world, totalling several hundred thousand members worldwide.
June 20 2012

The Honorable Herb Kohl
Chairman, Antitrust Subcommittee
U.S. Senate
Room 330 Hart Building
Washington, DC 20510

Dear Senator Kohl:

I am writing in my capacity as the Chief Executive of Apple Corps – the home of The Beatles. As you might imagine, we are watching with great interest as you and your colleagues consider the pending acquisition of EMI by Universal Music Group.

We have witnessed first-hand what’s been happening to EMI through a very difficult time. Despite their talented employees and the best of intentions, it is difficult for any business to flourish with revolving-door owners.

And now that Citigroup owns the company and is awaiting the approval of a new buyer, EMI’s recorded music group has effectively been left in limbo.

At Apple Corps, we depend upon EMI to respect and protect the culturally important Beatles catalogue and the historic Abbey Road Studios, where The Beatles and countless others made the magic which has touched countless generations.

Before coming to Apple Corps, I worked in various executive positions at several major record companies. I am very aware of the difficulties the music industry has faced over the past decade, and the challenges still ahead as the industry reshapes and reinvents itself.

We’re at a delicate time in our business and I strongly believe it is in the best interest of EMI to be owned – once again – by a true music company. EMI deserves the kind of leadership, passion and resources which Lucian Grainge and Universal Music Group can bring.

I’m confident, given the opportunity, they will revive and nurture EMI.

UMG is worthy of your support, Senator. Apple Corps needs a partner in this business for the long-term and the right reasons: I am confident UMG is that partner.

Cordially,

Jeff Jones
Statement of Senator Patrick Leahy (D-Vt.)
Chairman, Senate Judiciary Committee
Subcommittee Hearing on “The Universal Music Group/EMI Merger and the Future of Online Music”
June 21, 2012

Today, the Antitrust Subcommittee will examine the proposed merger of Universal Music Group and EMI and, importantly, discuss broader trends in the distribution of music online. Senator Kohl is continuing his efforts to highlight competition issues that will affect American consumers.

This discussion comes at a time of growth and change in the world of music distribution. Users can access music in more ways and at a broader range of price points than ever before. Fifty percent of all recorded music is now sold through digital distributors like the iTunes store. Internet-based services allow users to download individual songs and albums, stream individual songs on demand, or stream Internet radio. New technologies are promoting consumer choice and giving artists better ways to connect with fans.

Even as our ways of accessing music continue to grow, all platforms for delivering music still rely on one thing—quality content. As in all markets, it is important to protect competition to ensure that new music services can emerge and that existing distribution outlets can fairly negotiate reasonable prices. Our antitrust laws establish a review process by federal authorities to analyze competition issues in proposed mergers, and I have confidence that the Federal Trade Commission will consider the issues presented by the Universal Music Group acquisition of EMI fairly and thoroughly in its review of this transaction.

Today’s discussion with some of the leading participants in the music industry ties in with the Committee’s ongoing focus on developments in music distribution and online innovation. Last Congress, Senator Hatch and I introduced legislation that would ensure recording artists are compensated when their works are broadcast over terrestrial radio. I have also worked closely with Senators Feinstein and Graham on a way to create parity among the many different platforms through which we listen to music today. As the landscape for music distribution continues to evolve, we must ensure that our system encourages quality content by compensating songwriters and recording artists, while also ensuring the different platforms can compete and thrive.

I look forward to working with all stakeholders as we continue our efforts to promote innovation in the music industry while protecting the hard work of talented musicians and performers. I thank the witnesses for joining us today.

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June 11, 2012

Senator Herb Kohl  
Chairman, Subcommittee on Antitrust  
Committee on the Judiciary  
U.S. Senate  
330 HSOB  
Washington, DC 20510

Dear Senator Kohl,

As solo artists and members of Good Charlotte, we strongly believe in the merger of Universal Music Group and EMI Music.

We’ve been making music and touring for most of our lives, and EMI is our label and publishing company. Good Charlotte emerged at a pivotal time in the music industry. The changes in the industry have made for an unsettled environment. It’s really hard for new acts to break. The combined company would give needed stability to the music industry, and give new bands a better chance to be discovered.

Music is and always has been our passion, and so is connecting to our fans, but that doesn’t happen overnight. It takes dedication, hard work and resources. Strong companies, like a combined Universal Music Group and EMI, are needed to provide some of these pieces.

In this uncertain time, we hope you will support the combined company.

Respectfully,

Benji Madden  
Good Charlotte

Joel Madden  
Good Charlotte

Cc: Ranking Member Mike Lee
June 19, 2012

Senator Herb Kohl
Chairman, Subcommittee on Antitrust
Senate Committee on the Judiciary
330 Hart Senate Office Bldg.
Washington, DC 20510

Dear Senator Kohl,

As a newly-signed artist to the Universal family, I am writing in support of the combination of EMI and Universal Music Group.

I grew up listening to stacks of old records that were my grandfather's recordings. My tastes run the gamut from Pavarotti, Robbie Williams and vintage Sinatra, all of whom influenced my style and persona. All of these artists were supported by a strong management team and successful record company.

After being a finalist on the TV show "The Voice," my professional future continues to looks bright. But I am convinced that my future opportunities — and my livelihood — would be limited if I was not supported by a strong label and a partner that is able to support and nurture my work.

I have worked hard to build my global fan base by embracing social media platforms. Signing with UMG, I have a partner that understands and supports digital innovation.

I ask that you support the union of EMI and UMG so that artists like me can succeed and productive professional future. I know that this will benefit my fellow artists, and allow us to pursue our craft.

Sincerely,

[Signature]

Chris Mann
The Honorable Herbert Kohl, Chairman,
The Honorable Michael S. Lee, Ranking Member
Subcommittee on Antitrust, Competition Policy and Consumer Rights
United States Senate, Committee on the Judiciary
225 Dirksen Senate Office Building
Washington, DC 20510
USA

19 June 2012

Dear Sirs

Universal - EMI

I am the CEO of Music and Entertainment Rights Licensing Independent Network BV ("Merlin"). By way of background Merlin is a "one-stop-shop" recorded music rights licensing and enforcement organization representing the rights of hundreds of independent recorded music rights owners in Europe and North America on a non-exclusive basis. Merlin's activities are limited to the digital use of recorded music only and we offer new operators in particular, a highly efficient and cost effective means of accessing the repertoire of the many independent record labels and distributors we represent. While we have made reference to Merlin as a "virtual fifth Major" in marketing material, our reality is far from such status. We estimate our market share as approximately 2% of digital music and 1% of total recorded music in the U.S.

I am writing in connection with the proposed acquisition of EMI Music ("EMI") by Universal Music Group ("Universal"), which is currently under investigation by the U.S. Federal Trade Commission and the European Commission, and is the subject of an upcoming hearing before the U.S. Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights. Merlin opposes this transaction and we would offer the following comments for your consideration:

- the recorded music market is already highly concentrated with four major players controlling approximately 80% of the market in the USA. Universal is already the
market leader and its position would border on dominance if it acquired EMI. Taking into account its music publishing interests, it would have the ability to control around 50% of the music market.

- the acquisition of EMI by Universal would create the danger of an entrenched duopoly of Universal/EMI on one hand and Sony Music on the other. This would be a similar situation to that in a recent case, AT&T/T-Mobile, which was challenged by the Department of Justice as anti-competitive and subsequently withdrawn.

- the acquisition of EMI by Universal would not only add EMI’s existing market share to Universal’s, but would have a multiplier effect whereby Universal could leverage the value of EMI’s prize assets (e.g. The Beatles) to enhance the value of its own existing catalogue.

- the acquisition of EMI by Universal would enhance the “must have” nature of Universal’s repertoire giving it significantly more “hit” and other high value catalogue. In Merlin’s opinion, this would make it impossible for any digital music retailer to operate successfully without the repertoire of a combined Universal/EMI entity.

- Universal’s existing business practices suggest it has ambitions to act as “gatekeeper” to digital music services. The proposed acquisition would only facilitate its ability to do so and there are in fact already clear examples of music retailers (e.g. Google Music and VEVO) being prepared to launch services using only the repertoire which would be controlled by the potential duopoly referred to above.

- Merlin rejects the argument that an illegal activity such as piracy should be considered as a factor to justify further concentration on the market. In particular, this assumes that this illegality is a problem with no solution and confuses valid concerns over issues such as the interpretation and application of the Digital Millennium Copyright Act with invalid assertions that pirate content offers service providers a bargaining chip in price negotiations with record companies.

- a dangerous consequence of the Universal/EMI transaction would be to enhance Universal’s ability to distort competition in the digital world by incorporating certain inbuilt advantages it enjoys in the physical world (e.g. the limitations on retail shelf space which enable the largest players to translate their economic power into marketing dominance – essentially by buying the most prominent space to display their product to the exclusion of others’). Merlin believes this would be a hindrance to the development of successful online music services and broad consumer choice in the digital environment.

- although the internet makes it easier than previously to make a recording available to the public, this in no meaningful way substitutes the role of record companies in launching, promoting and distributing music. It is a fallacy that artists regularly achieve success on a so-called “DIY” basis (i.e. without the investment and support of record companies).
a merged Universal/EMI entity would be able to dictate commercial terms to music services such that it would become more difficult for Merlin to gain acceptable terms in return for the licensing efficiencies it offers. It follows that the more concentrated the market becomes, the less likely it will be that new digital services will be able to take advantage of the efficiencies offered by Merlin. Accordingly, the less likely it is they will be able to launch new services with the full offering of repertoire so vital to their success. This would militate against the creation of successful new businesses and a competitive market for consumers and ultimately against incentives for innovation.

Should you have any queries on the matters we have raised or more generally on Merlin or on the proposed transaction, we would of course be very happy to assist.

Yours faithfully,

Charles Caldas
CEO Merlin
Dear Sirs

I write further to last week's hearing on the above proposed transaction and the Future of Online Music, and to our letter to you of 19 June regarding the same.

Subsequent to that hearing, one of our member companies, Essential Music & Marketing, has brought it to our attention that Lucien Grainge of Universal's written statement at the hearing included a quote from an interview given by Essential's managing director Mike Chadwick. Mr Chadwick is concerned that Mr Grainge's testimony does not fully and accurately reflect his view and accordingly he has asked us to send you the following statement in order to put his full view on the record.

Yours faithfully

Charles Caldas
CEO Merlin

STATEMENT BY ESSENTIAL MUSIC & MARKETING MD MIKE CHADWICK

Lucien Grainge's testimony to the Subcommittee on Antitrust, Competition Policy and Consumer Rights last week contained a selective quote from an expansive interview I gave Music Week magazine in the UK earlier this year. Mr Grainge suggested that I believed the proposed merger was a positive step for the business. In fact, my interview offered a view in which I questioned whether the merger would be good for the music business.

To clarify further, my company is a sales, distribution and services company and tends not to compete on label or artist signings with Universal or EMI, however I nevertheless believe that the concentration of market power that would result from the merger would be a negative step for the industry and for independents.

My considered view is the increase in market share and market power of the merged company would give it too much leverage with important gatekeepers such as radio, TV, music magazines and other media, as well as across retail. Therefore, although the transaction could free up certain artists, given Universal's enhanced market power, those artists would have significant difficulty in accessing media and commercial outlets on level terms. A merger would also enhance Universal's ability to abuse its dominant position in the emerging digital market and this would be certain to disadvantage independents in their ability to compete across the world.
STATEMENT OF MARTIN MILLS
FOUNDER AND CEO
BEGGARS GROUP
TO
UNITED STATES SENATE ANTI-TRUST, COMPETITION POLICY AND
CONSUMER RIGHTS SUBCOMMITTEE

IN RE: The Universal Music Group/EMI Merger and the Future of Online Music

21 June 2012
A. BACKGROUND

1. Mr. Mills' Role In Independent Music.

Martin Mills established Beggars Banquet in 1974, initially as a series of record shops, and guided its expansion into the Beggars Banquet record label in 1977 and subsequently into other label and joint venture operations. The Beggars Group has established and participated in the 4AD and XL labels, amongst others. In 2002 it completed the purchase of 50% of Matador Records, one of America's largest and most respected independent labels, and in 2007 similarly brought the legendary Rough Trade Records into the group. The Beggars Group is now one of the biggest independent music groups in the UK, and worldwide the largest owner-run group of labels in the alternative sphere, with its USA headquarters in New York, as well as offices in Los Angeles and nine other international capitals, together with joint venture companies in Spain and Australia. The group now comprises four primary active current labels- XL Recordings, in partnership with Richard Russell, 4AD, Rough Trade and Matador. Following a split with his original partner in 1989, Mr. Mills is now the sole owner of the Beggars Group. Beggars was featured in the top forty of the Sunday Times Fast Track International 100 in 2010, and ‘Contra’ by Vampire Weekend became in the same year the first USA Number One album for a UK independent label for a quarter of a century. Fast Track again recognized Beggars in 2011, this time as one of the top 25 UK companies in terms of five year profit growth. Adele’s album “21” became in 2011 the biggest selling album worldwide, by far, and is now one of the ten most successful albums ever.

Mr. Mills has been actively involved in promoting the collective interests of the independent sector, and was instrumental in the original setting up of the Association of Independent Music in 1999, IMPALA in 2000, A2IM in the USA, and most recently the Worldwide Independent Network, each representing the interests of the independent music industry, and Merlin, the rights licensing and rights protection agency for independents. He has been Vice-Chairman of AIM and Chairman of IMPALA and a board member of A2IM, where he is being honored with the organization’s first lifetime achievement award, and is actively involved in music industry issues generally, through his participation in the government’s Music Industry Forum, the Music Business Forum, at the board of UK Music, and as a director of PPL and VPL, the industry’s rights licensing bodies. He was awarded an MBE in the 2008 New Year honors, as well as outstanding contribution awards from Music Week, the Radio Academy, the Featured Artists Coalition, and the Music Producers’ Guild.


2. Why Beggars Group Is Opposed to the Universal Music Group/EMI Transaction

Beggars Group believes that the proposed transaction is the worst outcome in competition terms for the music market and particularly for the
development of the online market. It will result in further concentration of an already concentrated oligopolistic market, and remove one of the closest competitors to Universal Music Group ("UMG"). This outcome is avoidable as there were other serious bidders for EMI (who would be likely to remain interested should the transactions be blocked and none of whom would raise the same regulatory concerns).

A UMG/EMI merger would produce a reduction from 4 to 2 Majors, not 4 to 3 Majors. It would transform the market into one where the two market leaders (Universal and Sony) face little competition from the one trailing Major (Warner) (collectively the "Majors") and the independents, fragmented and small competitors who are left even further behind by this transaction. There is no evidence whatsoever that their position is likely to improve in the future.

There is also the danger that there will effectively be a duopoly in the recorded music industry post this transaction. The UMG/EMI transaction would produce a significant reduction in competitive pressure on the two market leaders post-merger, resulting in unilateral anti-competitive effects. According to IFPI data for 2011 UMG/EMI and Sony would control 70.2% of the U.S. recorded music market.

This transaction is quite similar to the duopoly concentration levels which would have been created from the AT&T/T-Mobile merger, which was opposed by the Department of Justice and ultimately withdrawn. The concentration levels in the music market are higher than in the AT&T case, and the duopoly market shares are comparable. In that case, AT&T and Verizon would have been the duopoly with the trailing competitor, Sprint, having approximately the same market share as does Warner in this transaction.

3. Relevant Markets Impacted by the UMG/EMI Transaction

The physical and digital markets need to be looked at both separately and together. Whichever market definition is settled upon, revenues from the physical recorded music market remain important, with digital climbing to 52% in the USA for 2011 according to figures from the IFPI, compared to 31% for the world.

As regards the geographic definition of the market, Beggars Group considers that the market has both national and international characteristics.

B. COMPETITIVE POSITION OF THE MAJORS VERSUS THE INDEPENDENTS

Although "ordinary" market shares are indicative of market power, control of hits and the Top 100 and essential back catalogue ("must-have" repertoire), control of publishing as well as recording, distribution, scale, marketing power, vertical integration and access to media are equally important. When assessing market shares, there are a number of points to bear in mind:

1. Assessing market power through functional market share analysis

It is vital to count the market share of what a company distributes as well as what it owns, as that is what it uses in its commercial negotiations and is
therefore what dictates its negotiating power. That is why Universal’s arguments about looking at ownership are misplaced in the context of a competition or market power analysis. It is also important to note that increasingly the Majors are insisting that they also obtain online rights as part of a physical distribution deal. Of course charts based on ownership are important when it comes to assessing the independents’ sector contribution to innovation and diversity, for example, and should be published, but they are not an adequate measure of market shares or market power.

Market share of hits such as the Top 100 (and indeed the Top 10) are important because they generate the vast majority of sales both online and offline.

When looking at hits such as the Top 100, market shares must be based on actual revenues or some other weighting as ten hits at number 99 clearly do not produce the same market power as ten hits at position no 1.

It is crucially important to consider a company’s position in publishing and recording combined because a digital service needs to acquire both the recording rights and the publishing rights to a track in order to distribute it.

When looking at publishing, it is important to remember that many songs have more than one author, who do not necessarily have the same publisher. Each publisher of each part of the song can refuse a license, sometimes called “negative rights.” Each Major therefore can have effective control over significantly more music than that Major’s market share.

Back in 2000, Universal wrote to the European Commission to oppose the Warner/EMI attempted merger, saying “... in measuring market share, some account must be taken of jointly controlled work in assessing possible market power or dominance arising from the merger. It would be quite wrong simply to look at the works which are wholly controlled by the two parties and say that’s all you need to look at to see whether they would have market power or not.”

“Must-have” repertoire extends a company’s power beyond its market share. For example, Majors also use their lead artists to leverage their whole catalogue (e.g., ‘you can have Beyoncé if you also use my new alternative artist abc”).

(a) The competition risk of excess market power

Competition risks from high market shares and high market power apply across the whole market, not merely online. High market share produces excessive control of the whole market, including pricing and other consumer terms such as the amount of music available in free tiers of subscription services (e.g., Spotify), arising from the increased ability to shape online and other services using music. It also results in reduced innovation generally, fewer artist signings, lower market access for competitors (radio, retail, online, media, publicity), lower consumer choice and diversity. These are all equally detrimental ways of exploiting market power.

For these reasons, Beggars Group considers that there is no choice but to block the UMG/EMI transaction outright.
(b) Market shares of the proposed transaction

As of the IFPI data for recorded music market shares for 2011, all of the markets on a post-transaction UMG/EMI basis (combined shares as follows: physical—43.3%, digital—40.5% and total—41.7%) were “heavily concentrated” as defined in the United States Department of Justice Antitrust Division Federal Trade Commission Horizontal Merger Guidelines. See Horizontal Merger Guidelines (“Guidelines”) at 31.

The pre-merger concentration for the overall market is 2312, with a post-merger concentration of 2963 and a change of 651. The pre-merger physical recorded music product market HHI is 2499, with a post-merger concentration of 3269 and a change of 770. The concentration ratio for the digital market falls into the same orders of magnitude (i.e., pre-merger concentration of 2191, with post-merger concentration of 2744 and a change of 553). In all of the markets, the Guidelines dictate that these concentration ratios are “highly concentrated” and “potentially raise significant competitive concerns and often warrant scrutiny.” Guidelines at 32.

Moreover, the transaction will create an entrenched duopoly of UMG/EMI, with post merger market shares of 41.7%, and Sony, 28.5%, with a resulting duopoly share of 70.2%.

Universal constantly downplays its 30+% market share of total recorded music, and certainly makes light of the 40+% share resulting from the UMG/EMI transaction. It goes as far as to claim that market share does not equal market power. One should wonder whether Universal downplays its market shares in its commercial negotiations, in its discussions with music services about advances and equity, and in its arguments for splitting anti-piracy settlements. You can be sure that the 30+% figure is front and center, and the 40+% will shine even brighter if the UMG/EMI transaction is permitted to close.

It should also be noted that the real market share of Universal can be much higher depending on the territory, the genre, the week and whether we are looking at the whole market or hits, discussed in more detail below in the context of “must-have” repertoire. Finally, the market power which such market shares produce is also higher than the actual share due to the “multiplier effect” market share and market power give a company at Universal’s level. A good example of this phenomenon is Universal’s position in terms of publishing and recording. For example, Universal would for last week’s Billboard hit singles chart control have 8 of the top 10 singles. This gives enormous power to any company over any service needing a license for that music.

And of course, the real aim of this merger is to drive that market share even higher than the current total by leveraging the new combined strength.

Beyond the top 3, the recorded music market is highly fragmented with no participant in either physical or digital relevant product materials presenting any possibility whatsoever of being able to limit the duopoly’s exercise of
market power. The independents cannot be viewed as a block and the remaining market share would have to be divided between many disparate players.

Universal has been touting the Indies as a Major, able to exert “very significant constraints on anti-competitive behavior.” This contention is as far from reality as it can be. First, the “Independent” or non-Major, category data consists of hundreds and thousands of independent labels, none of which has more than 1-2% of the total recorded music market. While these are fabulous and creative companies they are not corporate behemoths capable of taking on Universal. We at Beggars Group have Adele, one of the biggest selling artists, yet we are a fraction of the size of the nearest major. This also helps to put context around the argument that the success of Adele proves the independents are major competitors. In any event, Adele has such a unique ability to touch so many people all over the world, she is a phenomenon, completely unstoppable, breaking all the rules and as everyone in the business knows, no conclusions from what’s happened can be drawn. If UMG wants to demonstrate the market impact of independents, it should look at the second and third biggest selling independent album of the year, or the biggest one from any other year. In many ways her success precisely underlines the barriers facing independent companies as she is actually signed to Sony in the U.S. to make sure she had the access to media required. It should also be remembered that UMG’s publishing affiliate publishes Adele.

Merlin, which provides agency services for independent labels in the field of online licenses for certain services such as streaming (not download, which is the dominant part of the digital market), estimates that it is a fraction of UNI/EMI’s market share and market power in the digital and overall market.

(c) The impact of removing EMI’s competitive pressure

Due to its position as the #4 Major EMI has been able to exert competitive influence upon its fellow Majors. EMI’s licensing of its music rights to Pressplay, a digital music service in which it had no equity interest which competed with a service that EMI had an interest in, set a new standard for the Majors. Previously the Majors had been averse to dealing with music sites they had no interest in. Forbes magazine touted this step by EMI as ground breaking, particularly so as it influenced the other Majors to follow its lead. Also EMI was the first Major to abandon the restrictive technology of DRM, a consumer friendly innovation that everyone ultimately adopted for downloads.EMI’s exercise of competitive pressure will be lost with this transaction.

For Universal, the increased concentration from the EMI transaction would simply mean adding more market power to Universal’s pre-existing strength, enhanced of course by the removal of a significant competitor, effectively a four to two reduction.

(d) Must-have or “incontournable” repertoire – Universal is already too big

Universal’s grip of “must-have” repertoire, already huge, will only increase in size post-merger. The heterogeneous nature of music content and the fact that music products are not substitutable for one another, unlike airline tickets or
bank accounts — means that a consumer wanting to buy a Lady Gaga album will not settle for Adele instead, which enhances the power attached to owning vast repertoire.

This power is also compounded by the fact that music services cannot succeed unless they have access to all the key repertoire. The repertoire of Universal has already been dubbed “incontournable” or “must-have” by the European Commission in its decisions in the UMG/BMG transaction, paragraph 270:

“The following analysis demonstrates that the merger clearly reduces the online providers’ possibilities to circumvent UniBMG . . . and the combined repertoire . . . even constitutes such a must have repertoire which cannot be replaced by other companies.”

It was also noted that the Commission had received replies to its market investigation, which indicated that “. . . Sony BMG and Universal are in any case required content as they make up the vast majority of hit material.”

At paragraph 254, the European Commission regulator found that:

“The market investigation indicates that in some cases major record companies with large record repertoires and high market shares have succeeded in imposing higher licensing rates for recording rights than smaller major record companies. The online and mobile music providers which reported such rate differences referred to the higher bargaining power of those majors with higher market shares as their catalogues are of greater importance for an online and mobile music provider.”

This position would be reinforced and the market power of Universal increased following the EMI transaction. What is equally important is not just the issue of licensing rates, but the impact on the licensed service as a whole through advances, minimum guarantees in terms of revenue or output, access to promotional and other shop windows, and the ability of such repertoire owners to use their power to mould the look and feel of music services and restrict the consumer offering.

The question is whether one Major holding as large a basket of repertoire as Universal currently holds causes antitrust concerns. The answer is assuredly in the affirmative. Given this, there is no argument for allowing Universal to grow any bigger through acquisition and thus increase barriers to expansion of competitors and of entry to new online services.

The substantial advances required by music labels and publishers have already been quoted as excessive and have been claimed to be relevant to the demise of recent innovative digital start-up Beyond Oblivion which was closed before launching its first product and whose costs of advances to rights owners were said to be up to $87 million since it opened in 2008. You can be sure UMG was at the forefront of that. Another example was Nokia’s music service
“Comes with Music”, which was initially licensed by Universal and came to market with huge expectations, but was effectively strangled by excessive financial demands and other controls which resulted in a service that consumers did not want.

Finally, it should also be noted that “must-have” repertoire can impact the physical market as well. In fact, it extends a company’s power across the whole market beyond its market share. For example, Majors also use their lead artists to leverage their whole catalogue (e.g., “you can have Beyoncé if you also use my new alternative artist abc”) when it comes to radio, television, and promotion.

2. The importance of scale and other factors relating to market power

Market power is reinforced by scale and marketing, as well as size of repertoire and access to media. To understand this better we need to consider what record companies do, how they operate and the barriers to entry and growth.

(a) Barriers to entry and growth

It is sometimes said that barriers to entry in the recorded music industry are low. It is after all relatively easy to make music and to put it on the Internet. That, however, is very far away from the business of being a record company, which does not just make music. Its activities are far broader, extending to seeking out new artists and genres of music, signing artists (and being asked to pay advances), making professional recordings in the studio, manufacturing CDs and other formats such as vinyl, distributing music in multiple territories, promoting artists to music critics, plugging radio and TV shows, multiple media in all territories as well as advertisers, being members of collecting societies in multiple territories, collecting revenues all over the world, negotiating with distributors and retailers all over the world, negotiating with global online services. That is why there are barriers to entry, and of course to growth, in the business. This is also why the Majors’ size and breadth reinforces these barriers, imposing barriers in and of themselves.

(b) The Majors’ access to the media

Generally, the Majors have a wider relationship with retail and all key media and routes to the consumer such as radio, television appearances, television productions, talent shows, video channels, and compilation in which the Majors leverage, as mentioned above.

Access to TV, radio and other media is key. My own company is pertinent here. We needed to agree to work with Columbia Records part of the Sony group for the U.S, to publicize our biggest artist Adele despite her worldwide acclaim.

Access to advertising opportunities, for example on radio and television, is also crucial. Bulk buying of TV advertising slots by the Majors occurs in almost all territories which limits opportunities for other companies.

Access to media in turn impacts a label’s ability to sign artists in the first place.
(c) The Majors' access to online services

In addition, the Majors have better access to online services than the independents. Universal, for example, can obtain better online deals than the independents and in addition has better market penetration, and access to media. This allows it to attract/consolidate major stars on the upstream market for signing artists. If independents cannot get an equivalent online deal for their artists, they may lose them to the Majors.

The Majors’ approach to the online market has been interesting in itself. Originally, as the Antitrust Division of the U.S. Department of Justice found in 2005, the Majors had tried to stifle the development of music platforms altogether for the legal on-line distribution of music, as their model was to control distribution as much as possible through their own platforms MusicNet and Pressplay. When the investigation was concluded, the DOJ found that such behavior had terminated.

Once the Majors embraced non-owned services, their strategy to control continued, but in a different way, with negotiations for equity in new services and effective approval over what services can and cannot offer, for example with Myspace Music, another failed venture. The Majors have also attempted to recreate the physical shopping experience or shop window online, with greater prominence given to listings of the Majors, and the Majors dominating advertising in the way they have offline.

The desire and ability to control new markets such as digital continues today. The Majors use the same tools to mould online services and direct consumers in the same way as they did with physical retail, to create barriers for other competitors and stifle innovation. They apply the traditional offline format to a new medium rather than allowing digital services the requisite freedom to develop new and innovative services for consumers. As mentioned above, the Majors have also used their market power to shape the look and feel of online services, as well as moulding the offering itself.

(d) 360 deals enforce the Majors’ dominance

Scale also impacts a label’s ability to offer 360 deals, a key way in which the Majors are able to attract and retain artists. 360 deals or multiple rights deals mean artists and labels collaborate not just on record sales but also on concerts, merchandising, publishing and other efforts. These deals are a key way that the Majors tie up artists on a long term basis. Although some artists and some independents do not believe that the model works for them, scale and access to key related sectors such as live, merchandising, and publishing are vital, and Universal is in an unparalleled position, and the recent Live Nation tie-up further enhances the attractiveness of Universal’s offer.
(e) **The practical results of the Majors’ scale and market power**

In the recorded music market, the scale and market power of the Majors gives them advantages over the independents at all of the following levels of the market:

- Access to the financial and corporate muscle required to grow and compete.
- Ability to sign artists and keep artists already signed.
- Ability to offer bigger and better 360 deals.
- Creation and production of recorded music.
- Access to huge back catalogues.
- Access to advertising opportunities.
- Access to radio - a 2009 study conducted by the American Association of Independent Music (based on radio playlist data) evidenced no measurable change in composition over the preceding four years, all of which was dominated by the Majors, despite changes mandated by the Federal Communication Commission to make radio access more open, which rules stemmed from the findings of payola (illegal pay for play) during the New York State investigation which resulted in settlements of millions of dollars paid by the Majors in 2005.
- Access to touring, merchandising and other increasingly important opportunities.
- Control of key facilities such as charts, collecting societies, industry associations and databases, anti-piracy actions.
- Access to distribution.
- Access to retail, and the terms of that access (including access to racking, in-store charts and in-store radio).
- Strength of market share in the charts (current and past) and other “must-have” repertoire.
- Access to media in all its forms – radio, TV, music magazines – as well as to advertising in order to implement an all-round marketing strategy.
- Vertical reach and integration.

Post merger these advantages will only increase for Universal, making it too powerful for effective competition to exist on the market, especially given the power of the competitors left behind, and creating barriers to entry/expansion in all of the digital music industry.
3. Competition from the independents

For the reasons cited above, the gap between the Majors, in particular the market leaders, Universal and Sony, and the independents, has never been bigger. The Majors have greater chart, radio and retail share than ever before. With few exceptions, the independents’ ability to break artists internationally and even nationally is severely compromised by the costs of marketing, restrictive licensing from Majors (which affects independent compilations and sample usage), and the targeting of artists, airplay, television exposure and retail placement by the Majors. On the upstream market of signing artists, the power of Majors to sign artists is much greater. Majors can pay more advances, higher royalties, invest more money for marketing and because of vertical integration with TV, movie or mobile networks, as well as live and merchandising, will be more attractive. Further, the Majors can rely on their vast back catalogues, which provide them with unique leverage.

All this means the gap between the Majors and the independents is increasing with only one or two independent labels enjoying more than 1% global market share.

Beggars Group has been a phenomenal independent success story in 2011 – Adele signed with XL Recordings, one of our labels. However, an artist like Adele is exceptional and comes along only every 15 to 20 years. Anyone working in the music business knows that no conclusions can be drawn from her success. In our case, in the U.S., it provides a neat example of why the UMG/EMI merger should not be allowed, as even Adele needed a Major, Sony, to work with her in the U.S., due to the importance of access to media.

What is also interesting is the reaction of the Majors to this success. One commentator, herself a songwriter, noted that a Major label executive had told her “We can accept XL having the biggest selling artist for one year. But next year it better be - it has to be - one of ours.” (Source: Guardian music blog 29 December 2011).

Of course, independents do succeed, on their own terms, and on their own home turf, often different from the Majors. We see this proposed acquisition as an attempt to restrict that.

4. Merlin does not provide competitive counter-balance

Merlin is a one-stop shop digital recording rights licensing and rights protection organization, providing certain opt-in services to members. It is only active in the recorded music market and only in relation to digital rights. It does not have agreements with the mainstream music services such as iTunes or Amazon, which are dealt with directly by Merlin’s member labels. It is not a label. It does not own or license or distribute or fulfill music. It is not in any way involved in publishing rights, or artist relations or management, A & R or in any promotional or marketing aspects which are vital in both the online and offline worlds. All of these tasks are carried out by music labels themselves.
It has been said that Merlin is the fifth major. Indeed it has called itself the “virtual 5th major,” but that does not mean it is a major record company. While Merlin has a significant number of independent labels as members, not all participate in Merlin’s licensing activity (because these members have negotiated away their rights to other parties or do not opt in to Merlin services). As a result Merlin’s share of the digital market is a fraction of UNI/EMI’s market share and market power in the digital and overall market - hardly the strength of a “fifth Major.”

C. VERTICAL INTEGRATION

The vertical aspects of concentration in the music market are vital.

Universal is truly a vertically integrated global company, as is Sony.

Universal is a subsidiary of Vivendi, an international media company with interests in media, telecommunications, mobile, video games, film, television as well as music. Universal itself is active worldwide in recorded music and music publishing. It also has activities in music catalogue management, merchandising through its full service merchandising company Bravado, artist management and media metrics (now enhanced by the Universal/Live Nation tie-up) and in music distribution.

VEVO is a good example of a joint venture between the duopolists (Universal and Sony) in the establishment of a music service. It demonstrates vertical integration of a distribution service by the market leaders, who clearly both separately and jointly control vital output for music.

In terms of distribution, although Universal recently sold Fontana, its independent distribution business, it retained a significant stake and continues to distribute through the company. This effectively means Universal continues to control an important part of the physical distribution business for independent labels in the U.S., which will be exacerbated if Universal is allowed to buy EMI and its independent distribution company, also a significant distributor in the USA. Fontana is also active in the digital distribution field via INGrooves who is now the main shareholder. As far as digital distribution is concerned generally, the number of options for independent labels has significantly decreased with Sony just completing a merger with IODA and the Orchard, the two main independent aggregators for independent labels. We expect distribution options for independent labels in both the physical and the digital market to be significantly reduced after the transaction. Again we see the emergence of a de facto UMG/Sony duopoly and an attempt by them to re-establish and increase their control of the market. Most of the Majors now operate label services divisions, offering resources to independent label and artists – but these should not be seen as altruistic support for the market, but rather as a means to lock in repertoire that might turn out to be successful, at no risk.

The Universal/Live Nation tie-up is also key, giving Universal increased market share through Live Nation artists (for example, Madonna’s new album is a Universal release), plus a foothold in all key markets linked to music from live to ticketing to artist management to social media metrics, merchandising etc., as well as recording and publishing. Is it in the public interest to allow such huge interests to work together and completely control the music market from A to Z, and then allow
Universal to attach another huge chunk of market share through EMI, neatly creating a new “tipping point” in the whole industry structure so that, no competitor can possibly compete?

The answer is clearly no.

D. DIGITAL MARKET COMPETITIVE DISCIPLINING INFLUENCES

1. Is there countervailing competitive pressure from digital platforms?

Every time this question has been examined by regulators, the answer has been no.

We understand that the European regulator specifically rejected this argument in its recent decision on Sony/EMI (public version not yet available). In its previous UMG/BMG decision the EC found that not even Apple would be able to exert effective constraints on UMG’s pricing behaviour (¶ 383-385 UMG/BMG).

The reality is that no company, no matter how big, can run a music service without Universal because its repertoire cannot be obtained elsewhere. For the same reason, we do not believe that physical retailers have countervailing power over the market leaders.

Universal touts that the digital and physical markets have developed around a “few players which exercise strong buyer power in their various fields,” and that the music business needs “sustainable market players” to thwart the “few players” and control the new innovators in the market. There is no reality to this argument. Universal does and will control a large portion of the music business. Any music service or purchaser that crosses Universal will be left with enormous holes in their repertoire, to devastating effect.

Jean-Bernard Levy of Universal seems acutely aware of this power. He specifically said the EMI transaction is seen as a way to ensure that it increases its muscle in relation to digital services stating, “In recent years our influence in the music market has declined... but the music business itself is rebounding.” Mr Lévy commented that by gaining muscle with the EMI bid, Universal Music would improve bargaining power in price talks with digital distributors. (See WSJ article “Vivendi defends its turf”).

Look at the terms Universal was able to impose on even Google for its new download service!

2. What is the impact of piracy and purported market decline?

Piracy is a problem but there are differing views on its impact. For example, one U.S study shows that, while a large percentage of Americans (around 30%) do pirate music, much of this piracy was casual. Legal streaming services also show signs of displacing some piracy: of the 30% who have pirated, 46% indicated that they now do so less due to the advent of low-cost streaming services (Source: The Copy Culture Survey: Infringement and Enforcement in the US from the American Assembly at Columbia University).
Even if we ignore such evidence, piracy is clearly not a competitor in itself. There is no sign in the market that the Majors reduced their prices or other demands to online services because of privacy. This goes against claims that piracy has exerted a restraining competitive pressure on Universal and Sony. We understand, for example, that the European regulator did not accept that piracy has a countervailing effect in its recent decision on Sony/EMI (public version not yet available).

In any event, even if the threat of illegal downloading were to limit the pricing power of any market player (which we do not accept for the reasons cited above), charging higher prices is not the only way in which market power can be exploited. Reducing investment in artists, limiting choice and reducing quality and reducing the value for consumers through restrictions on online services, are other ways in which market power can be exercised in order to increase profits, and the threat of piracy does nothing to limit the extent to which such strategies can be pursued.

In terms of market decline, music is hardly a failing market and neither is EMI a failing firm. All IP-dependent industries have struggled with the challenges of online, and music has arguably dealt with those threats first and best. Data shows the market may be reaching or has reached a tipping point as regards market decline in the USA. According to RIAA 2011 year-end statistics:

- U.S. music shipments in 2011 were up for the first time since 2004 (shipments of $7bn up 0.2% on 2010)
- Digital sales grew 9.2% on 2010, offsetting physical decrease of 7.7%
- Digital became more than half the market for the first time ever at 52%.

A recent study by Barclays Capital published by Music & Copyright on 29 November 2011 also sees a turnaround in sight. It sees annual growth in four of the top five markets by 2015 (Source: Barclays Capital forecast for annual music retail sales change in top five markets by format, 2011-2016).

What Sony boss Nick Gatfield had to say is also interesting. He noted that the digital revolution has not been all bad as 35% of Sony UK’s music sales come from online. He was also quoted as saying “In a weird kind of way this business needed a massive shakeup. It clearly got bloated on the back of the CD boom.” (Sources: Hollywood Reporter December 2011 and Guardian December 2011 “This business needs a massive shakeup”).

Universal executives Lucian Grainge and Boyd Muir have stated that the company encourages subscription services as a superior consumer alternative to piracy. Universal has seen a 13.5% increase in digital sales in 2011, this and increased licensing and merchandising income offsetting the decrease in physical sales, although revenues still decreased overall by 1.9% in the first half of the year but with a rebound in the second quarter (Source: Vivendi press release 31 August 2011 and see also FT article “Vivendi signals end of spending spree”). The third quarter 2011 figures also confirmed the rebound observed in the second quarter. In the FT
article mentioned above, a UBS analyst is quoted, saying “the [music] market may be reaching an inflection point after a decade of decline.”

All of this data stands in sharp contrast to the “sky is falling” arguments made by Universal in the press—significant declines in sales between 2001-2010. The reality is that the marketplace is in transition from the Majors’ carefully controlled physical market to the digital market, which they intend to be similarly carefully controlled. Universal needs the EMI transaction to increase its stranglehold over the digital market.

In any event, even if market decline continues/returns, it would do so for all players, and does not reduce the power of the individual Majors on the market, who would be competing within the same market structure.

On the basis of the above, piracy is not a competitor, the market is not failing, and the merger is specifically designed to give Universal more pricing and other power in the digital marketplace. Jean Bernard Levy, CEO of Vivendi, Universal’s parent, sums it up nicely as mentioned above when he said a few months ago—“The aim is to boost Universal’s bargaining power with mass-market stores and a new breed of online distributor, such as Apple and Spotify. By gaining muscle with the EMI bid, Universal Music would also gain bargaining power in price talks with digital distributors.”

3. Will there be an impact on innovation from the transaction?

Reduced staff and overheads necessarily results from mergers. With that comes a reduced ability to manage artists, which means fewer are signed and more are dropped or “put on ice.” Investment in innovating with new artists and genres will suffer as it has done with every merger in the past (see more below under “What will be the impact on artists?”).

So too will innovation in terms of online services suffer. As mentioned above, the Majors put up barriers to licensing of new services at the beginning of the digital market. The Majors have now embraced digital services but their ability to control innovation continues unabated.

The effect the Majors had on iTunes track pricing, getting the prices raised, is just one example. The effect they had on eMusic is another—with that music service decided it couldn’t survive on just indie music and brought on board the Majors one by one, it was the arrival of Universal that saw their front line pricing rise—and the consumer, and indie labels, lost their home on the web.

Universal will, post merger, have enormous power to shape deals with new services and crucially, the terms upon which other companies’ music is made available. This level of control does not benefit consumers, who, rather than being given options to choose from, are presented with services that the Majors have moulded.
4. Are there legitimate efficiencies flowing from the UMG/EMI Transaction?

In order for efficiencies to counter anti-competitive effects, they have to benefit consumers, be transaction-specific and be verifiable. It is difficult to see how any efficiency produced by this transaction would be of benefit to consumers. How likely is it that the transaction would produce lower prices, better products and service offering to consumers, in the short and long term? Not likely at all.

5. Does EMI need the UMG acquisition?

EMI is a thriving company. It holds very significant back catalogue artists including the Beatles, often seen as the crown jewels of the recorded music market. Coldplay is also in their repertoire. It is also key in classical and jazz with labels such as Blue Note. Its catalogue could make it increasingly successful as the digital market grows.

EMI’s main problem was its debt, which has now gone, making it a stronger player. In addition, EMI currently exerts significant competitive pressure on Universal and Sony. There were several bidders for both EMI recording and publishing. We believe that those bidders are still available and interested in EMI if the Universal bid is rejected.

For these reasons, Beggars Group believes that EMI would have a very successful future and does not “need” Universal.

Universal is understood to be making impressive claims about how it will invest in EMI in the future, for example by reinvigorating certain labels. We believe these claims need to be substantiated and compared to the overall picture of what will happen post merger, to the whole EMI company. It has never been the case in any merger that investment into artists has increased. The overall trend is always to decrease staff and investment in labels (and artists, whether existing signings or new potential signings, see below).

6. What will be the impact on artists?

Investment in innovating with new artists and genres will suffer post-merger. Fewer artists will be signed, artists will be dropped, catalogue will be less actively exploited (except for the “cherries on the cake”), and EMI labels and artists will be morphed into the Universal system. Cost savings are not possible otherwise. The same would happen as has happened following most other acquisitions – e.g., V2 and Sanctuary.

We have been told that artists being signed to EMI are being assured that only small and meaningless acts will be dropped. How will “small and meaningless” be defined?

We understand that Universal is also making certain claims about investment trends in artists by EMI which it claims has been decreasing and will be corrected by Universal. What is Universal’s own investment trend over the past few year? Our impression is that this has decreased for all major labels, not just EMI.
Exactly how would Universal increase its overall investment in artists but make the cost savings it needs to ensure the merger is profitable?

Finally, artist careers will also suffer from having even less bargaining power and will have one less door to knock on if they want to sign to a Major label. Career alternatives in terms of independent labels will be less attractive as those labels' market access will be further restricted by the proposed merger. Fewer artists will be able to make it to radio, television or obtain the best touring slots or the best exposure if they are not signed to UMG/EMI or Sony.

Universal have been touting that this acquisition has the support of artists, unions, and those who work in the creative music industry. It is true they have the official support of some unions who represent, amongst others, recorded music artists in the U.S. However, the worldwide federation of musician's unions opposes the deal, and does not understand why there is support in the U.S. The truth is that Universal, in its many guises, is already such a dominant employer that people dare not risk speaking out against them.

7. What will be the impact on consumers?

Based upon the above it should be clear that consumers will be adversely affected by the UMG/EMI transaction. Price increases, stifled innovation, excessively controlled online market, limitations on music choice for consumers, marginalization of independent artists and labels, and squelching of independent music development are among the ills that the transaction will exact upon consumers.

D. CONCLUSION

We appreciate the opportunity to bring the views of Beggars Group, and the independent recorded music world generally, on the anticompetitive consequences of the proposed UMG/EMI transaction to the attention of the Subcommittee. The transaction will lead to a loss of consumer choice, injury to competition, increased barriers to entry, impairment of innovation, further entrenchment of the Majors to the disadvantage of independent recorded music, increased molding of the online market and ultimately increased prices/reduced terms for consumers. This transaction should not be permitted to go forward.

Thank you.
SUPPLEMENTAL STATEMENT OF MARTIN MILLS
FOUNDER AND CEO
BEGGARS GROUP
TO
THE UNITED STATES SENATE ANTITRUST, COMPETITION POLICY
AND
CONSUMER RIGHTS SUBCOMMITTEE

IN RE: The Universal Music Group/EMI Merger and the Future of Online Music

28 June 2012
A. BACKGROUND

1. The 21 June Hearing

On 21 June 2012, the Senate Antitrust, Competition Policy and Consumer Rights Subcommittee ("Subcommittee") conducted a hearing addressing the merits of the proposed Universal Music Group ("UMG") acquisition of EMI’s recorded music catalogue, described by a hearing witness as "one of the greatest catalogues ever amassed in human history," and its effects upon the future of online music. I appeared as a witness at the hearing on behalf of my organization Beggars Group, and on behalf of the thousands of independent artists worldwide. Unfortunately my appearance at the hearing was cut short by the late start and my long-settled schedule which permitted me to be available only until the originally scheduled end time of 3:30 pm.

The other witnesses at the hearing were Lucian Grainge, Chairman and CEO of UMG, Roger Faxon, CEO of EMI, Irving Azoff, Executive Chairman of Live Nation Entertainment, Inc., Edgar Bronfman Jr., Director of Warner Music Group Corp. and Gigi Sohn, President and CEO of Public Knowledge.

I seek the indulgence of the Subcommittee, if I may, to submit this Supplemental Statement to address a number of the issues raised after my departure as well as certain issues that I was not able to fully explore at the hearing.

B. ISSUES FOR DISCUSSION

1. Do Record Labels No Longer Have Power Over Access or Price?

Messrs. Grainge and Faxon repeated the refrain that record labels no longer have power, that the internet has given all of the power to the artists. So the colossus of market size that this acquisition creates in UMG would not translate into market power, they claimed. This assertion is absurd. No musician can truly exploit their art without a record label. Yes, artists can do certain things on their own, but they still need labels. Even those bands which have released albums without record companies have been able to do so only because of their prior success, due to long-term investment and marketing by record companies. For example, Radiohead released an album digitally on their own (but with paid-for record company services), but their career had been built on EMI investing in and marketing five prior albums. It is disingenuous to suggest that this path is open to a brand new artist with no track record.

Access is democratized, but not success or revenue. New artists still need label services to succeed. There are numerous examples of artists with quality music who had to turn to a Major to see their work given the exposure they needed. Adele needed to turn to Sony in the U.S. for its power with the media. Even Mr. Azoff of Live Nation had to admit that his example of One Direction (which he described as coming off SiriusXM Radio) had signed with Sony. Amanda...
Palmer, who raised $1 million on the internet and was previously part of a famous band, is the most recent example, still needing a label, signing last week with Cooking Vinyl.

Interestingly, UMG is trying to suppress a report by the influential trade group International Federation of the Phonographic Industry which focuses on the importance and value of record labels - a report previous versions of which UMG has supported and endorsed. So UMG is trying to manipulate industry information to improve its case in front of you and the Federal Trade Commission. We would refer you to a recent New York Post article regarding this (copy attached as Exhibit A, or see http://www.nypost.com/p/news/business/big_power_player_9MjMhJRib6TDQ0cPeBWN?utm_medium=rss&utm_content=Business). I believe that this report clearly includes facts that contradict UMG’s arguments, and that is why it is attempting to suppress the report until after the Federal Trade Commission and the European Commission have concluded their investigations.

Moreover, the market reality is that artists do not negotiate contracts with music services - labels, and primarily the Majors, do. The fact that Majors might not control all artists all of the time is not the point. The only thing that matters is who controls the terms which engage the public. It is not artists who negotiate with Google, it is labels. The reality is labels are still the ones with the power. The reality is that not one single service can do anything without major label buy in, especially UMG. They control the terms of the contracts with the services, the advances, the equity and the preferred positions. The bigger you are the more power you have to dictate. Lucian Grainge said it himself when talking about his “must have” artists, so why would we give him more?

Both UMG and EMI contended that they cannot control the price of their music; the big retailers control price in the physical world and the music services control price in the digital world. The history of the Majors has seen many allegations about their efforts to set the price of their products. There is no reason not to expect the same in the future. As to the big retailers, EMI stated that recorded music represents less than 0.3 percent of their turnover. Well for WalMart alone, whose fiscal 2012 net sales were $443.9 billion, that 0.3% (if accurate) represents $1.33 billion in recorded music sales. No right thinking retailer is going to push those sales off their shelves over a price increase. The reality is that UMG post-transaction will be large enough to push its competitors off the big retailer’s shelf space.

As to the online world, UMG has already been successful (with its fellow Majors) in pushing iTunes to raise its top line price in 2009 from $.99 to $1.29 per single download. With its added bulk in repertoire from the EMI transaction, UMG’s capacity and inclination to effect the price of digital music through overt steps, as well through onerous licensing terms, will be strengthened.

2. What is the Acquisition’s Effect on Competition?

Messrs. Grainge, Faxon and Azoff deftly avoided one of the key questions that the hearing was intended to resolve. What would be the effect on competition? Senators Kohl, Lee, Franken,
Blumenthal and Klobuchar all recognized the harsh reality of this transaction—a moderately concentrated market would become a highly concentrated market. And as the U.S. Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines specifically presume, such concentration will “be likely to enhance market power.” Only “persuasive evidence” showing that the merger is unlikely to enhance market power” can overcome that presumption.

Where was the “persuasive evidence”? It certainly did not come from the UMG, EMI or Live Nation witnesses. Even Mr. Bronfman of Warner (a Major itself) noted the ills of such levels of concentration, including the lack of access to services on comparable terms and collapse of consumer choice as a result of the UMG/EMI transaction. There was a complete failure on the part of the transaction proponents to rebut the presumption of enhanced market power. Indeed Mr. Azoff of Live Nation testified that UMG/EMI would have “virtually the same” market power as they had separately before the transaction. Perhaps even more tendentious was Mr. Grainge’s assertion that the 4 to 3, or rather 4 to 2, duopolization-effecting merger of ATT and T-Mobile (blocked by the Department of Justice) was not “relevant” to the same concentration metrics present in this transaction because—UMG has “no direct relationship with consumers.” Where in the antitrust laws does this exception come from? Why even raise such a point? The answer is simple—to distract attention away from a powerful analogy where the post merger concentration levels and changes in concentration were nearly identical, with the same potential for increased prices and limits on competitive choices for consumers, all of which caused the Department of Justice to sue to block the transaction.

When presented with a quote from the Chief Financial Officer of UMG’s parent company, Vivendi, to the effect that UMG’s market shares in North America and most European countries were too large for it to acquire either EMI or Warner, Mr. Grainge’s response was only “I disagree with him”—not the “persuasive evidence” necessary to overcome the presumption of market power that applies here.

I would also like to pick up on the point that Senator Blumenthal raised — what are the unique characteristics of the record market such that normal competition law principles and thresholds should not apply? They should apply more strictly to this market since the nature of copyright is that it is a monopoly, non-substitutable good, and thus its ownership is more capable of abuse. I would also underline that this merger will create anti-competitive effects not just with regard to online, but across the whole market from physical to media to online as well as in key vertical aspects.

3. Is it “Insane” for UMG To Not Deal (Fairly) with Music Services?

Mr. Grainge repeated a number of times that it would be “insanity” for him not to deal with all online services and that it would violate his duty to his artists. Curiously, Mr. Grainge could not discuss any of the particulars of the Deezer or Spotify music service contracts although they are two of UMG’s most significant digital retailers. The reality is that UMG picks and chooses its music services, and then demands onerous terms from the services such that independents, like
Beggars Group and others, have little flexibility to negotiate terms. It’s not just a question of whether Universal will contract with services or not, it’s a question of on what terms.

While Mr. Grainge testified about hundreds of deals with music services that UMG has done, the Subcommittee has heard from none of those services about the terms of those contracts or of UMG’s evenhandedness in negotiating.

The eMusic situation is an example of UMG’s treatment of music services. eMusic’s former CEO has reportedly said that UMG told him UMG “don’t swing that way” when asked to do a deal along the lines of an earlier deal. The deal that UMG imposed on eMusic dictated the shape of its consumer offering with increased front line pricing. Another good example would be Pandora. While it now has a collective license for rights through SoundExchange, if its license ceased to be a collective one then it is crystal clear that UMG, being first in line, would exert its leverage to get at least 10% more than its 40+% post merger market share, with the other Majors trying to maintain their market share portion and Pandora needing to clawback the extra 10% given to UMG from the independents — or from increased consumer pricing. This is how UMG works now, and it would be able to exercise that power to a far greater extent after the EMI acquisition. Make UMG one third more powerful and its ability to compel onerous terms increases geometrically. In any event, is it in the interests of competition and innovation in the online market that one company should have such control over the development and look and feel, as well as the very existence, of digital services?

At the hearing, Mr. Grainge seemed keen to distinguish his approach from that of his predecessor Mr. Morris. In the particular context this was raised, that would suggest that UMG’s approach to controlling digital businesses, negotiating equity or other stakes in the business or other forms of participation or control is different with Mr. Grainge as CEO. Does that mean UMG stopped all negotiations relating to such elements after January 2011? We believe UMG continued and continues to pursue such results in its negotiations. And now that Mr. Morris is running Sony, and presumably has taken those opinions with him, reinforcing their existing practices, is Mr. Grainge seriously saying that he allows a competitor to obtain terms that he does not seek himself? UMG is now, for example, apparently trying to suppress a report by the influential trade group International Federation of the Phonographic Industry focusing on the importance and value of record labels – a report previous versions of which it has supported and endorsed. See Exhibit A.

4. What Future Does EMI Deserve?

The proponents of the UMG/EMI acquisition would have the Subcommittee believe that EMI “needs” this transaction and that EMI will retain its freestanding status. Does EMI need the dollar investment of the market leader or does it simply need the investment of a stable and focused company willing to give EMI the chance it has been denied under Terra Firma and Citigroup? Plainly, the answer is that EMI needs a chance from anyone and UMG’s only real attraction is that it offered more. On the point of EMI retaining its freestanding status, the answer should be obvious. No company would pay $1.9 billion and then let its investment go off on its own. Any purchaser would seek to realize financial synergies. And the notion that Capitol
Records will rise like the phoenix and take its place in the constellation of Majors needs careful review. Even if Capitol is revived in some way, what is the likelihood that overall there will be more investment? After the transaction, EMI will cease to exist and UMG will simply be bigger than it is now. This is what has happened sooner or later to every other record label that UMG has purchased.

5. Does Piracy Have a Price Dampening Effect?

Senator Kohl raised the question of how iTunes was able to raise prices in the face of rampant piracy. Mr. Grainge’s response was that iTunes had not raised its prices in nine years and a price increase was justified. Mr. Faxon’s response was that there had to be an effect on price from piracy due to the amount of music pirated.

The reality is that the transaction proponents have no evidence that piracy limits the ability of the services or the Majors to price as they see fit. The only examples we have are of effective price increases and Mr Grainge clearly indicated it had been time for another one. The consumer is the prey of this whole endeavor, and they will suffer from the UMG/EMI transaction. How likely is the opposite?

6. What Effect Will the Transaction Have on Broader Music Choice for Consumers?

Senator Klobuchar posed a key question at the hearing about the impact of the UMG/EMI transaction on the availability of music to the public and the ability of more bands to get into the music business. The actual consequences on future musicians is unknowable. But a world where 4 Majors have been reduced to 3 (and in reality from 4 to 2 with Warner trailing behind offering little competitive restraint due to the increased gap) does not bode well for the ability of new bands to make successful entry. It is critical to remember that UMG makes money only on commercially successful artists and thus cannot afford to take risks on left field talent, which could be the music legends of the future, in the way that small companies, like the independent labels, can. The same will be even truer in a UMG/EMI future. My own experience suggests that there will be less music rather than more with a super Major like UMG. Artists will have fewer options and reduced negotiating power and if they are not on UMG/Emi or Sony, will be less likely to “make it.”

7. What Effect Will the Transaction Have on Retailers?

UMG contended at the hearing that the big retailers could exercise monopsony power to prevent it from engaging in price manipulation, and indeed that labels are unable to control or set prices. With UMG having a disproportionate share of the physical and digital recorded music
markets, does anyone wonder who has the power in these negotiations? If you, as a retailer, want the commercially successful artists like Lady Gaga or Katy Perry, you have to find an arrangement with the Majors. The truth is that price setting is within the control of the Majors, and is the product of negotiations with retailers, in which the Majors have the ultimate power, and for which the consumers pay the price. Even within my own company, which obviously has to operate within the parameters set by the market leaders, we are able to choose between a number of price points at which we sell music, and choose our own prices, subject of course to consideration about what the market will bear.

8. Do Shrinking Revenues/Profits Justify Permitting This Transaction?

Both Mr. Grainge and Mr. Faxon complained at the hearing that overall recorded music revenue had declined by half since 2001. The unspoken argument here is that this decline, by itself, warrants approval of the transaction. In U.S. antitrust law, there is the doctrine of a “failing company” which permits other- wise anticompetitive transactions to be consummated in order to salvage the distressed company. But here the doctrine plays no role because UMG has a very strong balance sheet (it can afford to spend $1.9 billion for EMI’s recorded music repertoire) and no one at the hearing suggested that EMI was in a “failing” condition.

So why raise the decline? The reason seems obvious—UMG and EMI are hoping that the Federal Trade Commission and the European Commission will see the recorded music industry as in decline, with diminishing capacities to effect price or access. Yet in 2012, online music is growing by leaps and bounds, and even Mr. Grainge spoke at the hearing of “the potential for growth.” The whole shrinking revenue/profits argument is a sham built on old data applied to a different lifetime in recorded music. UMG is willing to pay $1.9 billion for EMI because it is betting on a big return from its investment, which return will come off the backs of independent labels, artists and consumers.

9. What does the European Commission Say About Buyer Power and the Effects of Piracy?

I would like to conclude by drawing the Subcommittee’s attention to the report issued this morning by the European Commission setting out its findings regarding Sony’s acquisition of EMI’s music publishing rights. The specific conclusions relevant to what we discussed at the hearing are:

- prices should have gone down for online licensing but did not;
- the more repertoire you control the more you get from those you license;
- online customers do not have buyer power;
- piracy is not a competitive constraint;
- the transaction is likely to result in increased prices and other negative consequences for competition and consumers.

While this is a music publishing case, I believe that it is relevant as it indicates the existence of competitive problems when there is too much music repertoire in the hands of one company.

C. CONCLUSION

Much was said at the hearing about the free market. My view is that the free market is precisely why this merger should be stopped. If it is not stopped, competitors will be squeezed even more, which means that the market will not be free—just squeezed. Fewer great artists will have a proper career, fewer entrepreneurs will succeed, and as I testified at the hearing, a Beggars Group could never grow into what it is today. That is not what I call a free and competitive market.

To sum up, UMG is basing its argument on three points:

1. That record labels no longer have power. That the Internet has so enfranchised access to market that greater size does not confer greater power.
2. That of course they will license any new digital service, that’s their duty to their artists.
3. That they will invest in EMI, and retain its freestanding status.

I don’t think any of these arguments is credible— but the key thing is that having advanced them, they then could not answer your simple question “why then spend all this money, more than anyone else thought it was worth, and at such a risk?”

Because the simple answer to that question, the one they can’t give, is the one I gave—that it’s about control, and competitive advantage.

If America is to say yes to the free market, it has to say no to domination, America has to say no to this transaction.

Thank You.
EXHIBIT A
EXCLUSIVE: Universal Music Group being blamed for delaying release of music-industry market share...

**New York Post**

**Big power player: Music rivals rip Universal move**

By CLAIRE ATKINSON

Published: Sun, Jun 23, 2013

Universal Music Group's attempt to put its own spin on an influential report on the music business has competitors fuming.

The move has backfired.

Universal, the industry's top player, is being blamed for delaying the release of the market-share report while it tries to gain regulatory approval for its proposed $1.9 billion takeover of EMI's recorded music business.

Yesterday, the International Federation of the Phonographic Industry was slated to hold a press briefing with top music executives in London to unveil its latest report, "Investing in Music:"

The event was canceled, however, when fighting broke out over the report.

According to two sources, Universal, run by CEO Lucian Grainge, wanted to downplay the role of the major record labels in launching and shaping new artists.

At the same time, the record giant wanted to add new wording on growing competition in digital music distribution from new services such as TuneCore and The Orchard, which works with independent labels to gain distribution.

Sources said that Universal wouldn't sign off on the report unless the changes were made, while rivals refused to OK it if the IFPI bowed to Universal's demands.

"This report suddenly doesn't make sense," said one music source. "It's really unfair."

Universal insiders denied trying to hold up the report, saying they simply want it to reflect the realities of today's marketplace.

All four labels have to agree on the wording of the report before it can be distributed.

Frustrated by the back and forth, IFPI head Frances Moore e-mailed the labels last week, saying that if they couldn't agree, the industry group didn't want to play referee. Moore told parties the report would be delayed until fall.

London-based IFPI couldn't be reached by press time.

Universal's bid for EMI is the music industry's biggest deal in years, and will reduce the number of major labels from four to three. With the purchase of EMI, Universal's share of the global music market would jump from 30 percent to about 40 percent.

Last week, Universal's Grainge and other top music execs testified before a Senate subcommittee on antitrust issues over the EMI deal, which needs approval from US and European regulators.

"I have no doubt labels add value, but you just don't have to have one in a world where an artist can deliver an album to fans themselves," said Live Nation boss Irving Azoff, who testified in support of Universal.

The delay in the IFPI report means it likely won't be released until after the European Union rules on Universal's EMI acquisition by Sony.

Universal is expected to receive details of the EU's "Statement of Objections" toward the end of this week. The Vivendi-owned company then has 30 days to respond to the letter with its remedies.

Separately, the Federal Trade Commission is expected to rule in favor of Sony's deal to acquire EMI's music-publishing assets as early as next week. Sony's deal, in partnership with a host of investors, will see EMI Publishing run as a separate venture alongside Sony/ATV.

Universal, Sony and Warner Music Group declined to comment.

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6/28/2012 http://www.nypost.com/fprint/news/business/big_power_player_9MjM0RhF7DQoPmBWN
Testimony of

Casey Rae
Deputy Director, Future of Music Coalition

On
“The Universal Music Group/EMI Merger and the Future of Online Music”
Hearing

Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights

June 21, 2012
Chairman Kohl, Senator Lee and members of the committee, it is an honor to submit the following testimony for the record in such an important hearing.

My name is Casey Rae, and I am the Deputy Director for Future of Music Coalition (FMC), a national research, education and advocacy organization for musicians. I am also a recording artist, producer and small label owner. Each of these roles has provided me with valuable insight into how the independent music sector functions on a practical level, as well as how technology has impacted artists and songwriters in positive and less-than-positive ways.

The organization that I represent, Future of Music Coalition, works to ensure a diverse musical culture where artists flourish, are compensated fairly for their work, and where fans can find the music they want. For more than a decade, FMC has helped musicians and independent labels navigate a complex and evolving marketplace for music.

This testimony was compelled by concerns over the proposed acquisition of EMI Music by Universal Music Group (UMG). A majority of these concerns can be extended to a deal in which Sony/ATV aims to acquire EMI Music’s publishing assets. If approved, these acquisitions would provide UMG with more than 40 percent market share in recorded music in the U.S., and would make Sony the biggest music publishing company in the world. Effectively, two major record labels would have tremendous influence over crucial online access points, with the power and incentive to curb the very kind of innovations that drive the new music economy.

As a staunch advocate for musicians, I am concerned with how a more powerful UMG could affect the playing field for creators, especially online. It is common knowledge that the internet is an extraordinary tool for the exchange of information and ideas. It is also a powerful engine of creative expression and commerce. New digital music services, for example, offer consumers access to a wide range of repertoire at relatively modest costs. Artists, once restricted from the broader marketplace by gatekeepers and middlemen, now have unprecedented access to audiences. It is
encouraging that there are more legal, licensed online music services than at any time in the past. Yet the compensation structures and feature sets of these services vary, in part due to the influence the major label system wields over the music marketplace. Should this acquisition go through, we could see a vibrant ecosystem of creative expression and innovation compromised by just a couple of companies with tremendous leverage over which platforms are allowed to exist and how they function.

The current environment for music conglomerates is hardly the epitome of competition, but it can at least be said that no single major record label or publisher dominates the market. The biggest players hold approximately similar market shares, which helps maintain a competitive balance. In turn, this encourages transparency and broader dissemination of music as companies compete to make more of their content available across digital platforms. Absent sufficient competition, UMG may be tempted to recreate scarcity and withhold catalog — through direct refusal to license, or by making the burden of lawful acquisition too great for the majority of market entrants. In a cruel irony, such behavior would ultimately fuel the scourge of unauthorized distribution that so many of us seek to eliminate.

Musicians are consumers. Many of us are also entrepreneurs who run small businesses that are seeking a foothold in a complex and evolving marketplace. The artists, managers and independent labels with whom Future of Music Coalition engage believe that the new marketplace must be built on not only the development of innovative platforms, but also direct access for creators and mutually-rewarding licensing terms. Our extensive documentation of the effects of consolidation in other sectors, such as commercial radio and ticketing, does not indicate an increase in artist access or leverage. In fact our research has quantitatively shown the opposite. This leads us to conclude that, to achieve a robust and legitimate digital music marketplace, there must be active participation by a diverse array of players, as well as a high level of competition rather than market concentration.
We understand that musician and performer unions such as the American Federation of Musicians (AFM) and the American Federation of Television and Radio Artists (AFTRA) have shown support for the merger. Both of these groups do incredible work on behalf of musicians and performers, and have long histories in advancing and protecting the rights of American creators. However, it is difficult to see how this proposed merger would benefit musicians, songwriters and composers.

Conversely, a recent letter to the committee from the International Federation of Musicians (IFM) echoes many of the points outlined in this testimony. As the letter states, “The problems that artists have been facing in the traditional market for many years are even worsening in the digital world, from which they usually receive insignificant incomes. Should the merger be authorized, artists would lose one of the remaining four alternative routes to access the mass market... According to our members’ experience of similar mergers in the past, the new duopoly would also mean less investment, lower quality, fewer jobs, narrowed consumer choice as well as reduced cultural diversity.”

The question of competition is important and germane to the regulatory review of the proposed merger(s). Likewise, the impact on consumers must be taken into account. However, as previously mentioned, musicians are also consumers, and more than ever before, they must be viewed as stakeholders in such an examination. More crucially, because of the nature of today’s marketplace, independent and unaffiliated artists will be affected by whether these mergers are approved. Therefore, the independent sector must be factored into any appraisal of the overall health of the music marketplace.

There is still much to be done to identify and nurture business models that make sense for both creators and consumers. The persistent issues around licensing may be outside the scope of antitrust review, but their resolution is nonetheless central to the growth of the legitimate digital music marketplace. If the history of digital music is any indication, greater market concentration may mean we never see tomorrow’s amazing innovation. Worse, we may not be able to achieve the kinds of structural reforms that could help
more creators get paid more often, while eliminating the incentive to piracy. In other words, preserving a level playing field for musicians and innovators built on competition and access necessitates a rejection of these proposed mergers.

Putting too much power in the hands of massive players would marginalize competition and artistic expression. First, there is the fundamental matter of promoting diversity in musical culture, with clear onramps to potential audiences. Second, there is the need to ensure that musicians and songwriters receive monies owed, and under equitable terms. Even today, the major labels are able to dictate compensation structures on emerging platforms and tilt the balance in their favor through a range of demands on digital music services. Independent and unaffiliated artists simply do not have the leverage to compete, but we experience the downstream effects of such deals. More market power in the hands of fewer companies means that any influence we have — however slight — would be further diminished.

Growing the legitimate digital music marketplace is in the best interests of the entire music community. This goal is not advanced, however, by further concentration in the recorded music industry. We thank the committee for its attention to these issues, and advise that your evaluation take into account the experiences of the independent artists and labels that power so much of today’s music marketplace.

Thank you for the opportunity to offer my perspective on these matters.

Casey Rae
Deputy Director
Future of Music Coalition
Testimony of Gigi B. Sohn,
President, Public Knowledge
On behalf of
Public Knowledge and Consumer Federation of America

Before the
U.S. Senate
Senate Judiciary Committee
Subcommittee on Antitrust, Competition Policy, and Consumer Rights

Hearing On:
“The Universal Music Group/EMI Merger and the Future of Online Music”

Washington, DC
June 21, 2012
Testimony of Gigi B. Sohn,
President, Public Knowledge
On behalf of
Public Knowledge and Consumer Federation of America

Before the
U.S. Senate
Committee on the Judiciary
Subcommittee on Antitrust, Competition Policy, and Consumer Rights

Hearing On: The Universal Music Group/EMI Merger and the Future of Online Music

June 21, 2012

Chairman Kohl, Ranking Member Lee, and Members of the Subcommittee, thank you for this opportunity to discuss the significant consumer harms the Universal Music Group ("UMG") and EMI Music merger would cause if allowed. My name is Gigi Sohn and I am the President of Public Knowledge, a nonprofit public interest organization that addresses the impact of copyright on competition and innovation in digital technology.¹

Introduction

The proposed merger of the major record labels UMG and EMI Music comes at an important time for music fans and the music industry. Innovative companies using digital technologies have found new ways to give musicians and consumers more choices for how and where to create and experience recorded music. Digital music distribution in particular has benefitted consumers by enabling them to access music more conveniently and more directly from the artists. Gone are the days when music fans could only listen to the latest album if they traveled to a physical record store, bought the album, and brought it back home to play on a home stereo system. Now, digital technology allows consumers to buy music at the click of a button and listen to that music on their stereo, computer, mp3 player, smartphone, or any number of personal devices. Digital platforms also dramatically decrease distribution costs, which in a competitive market results in cost savings for the consumer. However, nothing is immune to market power and a merger of this magnitude can easily stifle the consumer benefits of digital distribution.

These technologies hold great promise for recording artists and consumers, but nascent entrants in the market dependent on licenses from incumbent labels are vulnerable to anticompetitive behavior by the major labels. For example, the company Deezer, digital music streaming service similar to Spotify, has enjoyed success in 81 countries around the world, but does not offer its service in the U.S. Deezer has also

¹ I would like to thank my Public Knowledge colleagues Jodie Griffin, Ernesto Falcon, Martyn Griffen, and Clarissa Ramon for assisting me with the research and drafting of this testimony. I would like to give special thanks to Mark Cooper, Director of Research, Consumer Federation of America for his assistance.
partnered with numerous other companies, including social networks like Facebook and Twitter, mobile telephone services like T-Mobile, stereo system manufacturers like Sonos and Logitech, and car manufacturers like Nissan and Parrot. These partnerships create new services that increase music fans’ opportunities to enjoy music conveniently and at a reasonable price. But when asked why none of these innovative new services have reached the U.S. market, Deezer representatives point to the cost of licensing the music from the major labels.

The major labels can thwart or seize control of innovation with anticompetitive behavior against new market entrants that cannot operate without sound recording licenses from the major labels. The merger between UMG and EMI would create a new super-major label that controls 41% of the recorded music market, and could use that market share to stifle the development of new digital platforms while raising prices to the detriment of both musicians and their fans. To prevent this result, antitrust authorities must block this merger to protect the future of innovation, competition, and pricing in the music business.

Digital technology’s ability to let artists reach fans directly has been a powerful, consumer-friendly, competition-friendly force in the music industry. However, it is not immune from the abuse of market power by entrenched physical space incumbents. Incumbent major record labels have the incentive to stifle new digital distribution platforms because those platforms begin to level the playing field among major labels, independent labels, and unsigned artists. Digital platforms are more likely to license unknown or niche music because, unlike their physical space predecessors, they are not constrained by time limits (like radio) or space limits (like physical stores). As a result, the major record labels lose one of their main selling points to musicians—namely, that they have the connections and influence that a musician absolutely needs to get his or her music out in the marketplace. Thus, the dominant incumbent labels are particularly incentivized to stifle digital platforms that will decrease their influence as compared to smaller competitors or unsigned acts.

This merger bears striking similarity to the recent failed merger attempt by wireless carriers AT&T and T-Mobile. Both proposed mergers threatened to drop the number of major competitors from 4 to 3 and radically change their respective industries. Both mergers would have strengthened the power of an already-dominant firm to stifle its competition in the marketplace. And in both mergers, the acquisition target (T-Mobile and EMI, respectively) was the fourth-largest firm in the marketplace with a proven track record of pressuring the larger firms as a maverick competitor. In the AT&T-T-Mobile merger, the Department of Justice recognized that the deal would impose serious harms on consumers and rightfully filed suit. Just as the government protected consumers by fighting the AT&T-T-Mobile merger, the antitrust authorities should prevent Universal from buying out one of its most innovative competitors.
EMI Music Has Historically Been Willing to Take Risks and Innovate

As the fourth largest label in the marketplace, EMI must continuously explore opportunities to grow market share by attracting customers and recruiting new talent. Unlike its larger competitors, EMI cannot be complacent and focus on merely preserving its market share but rather must be a scrappy contender willing to try the unorthodox. With regard to digital music services, EMI Music has consistently been the first major label willing to take risks and innovate. As a result, consumers have reaped the benefit of music that can play on more devices and services than ever before at price points they demand and artists have benefited from having a label more willing to meet their needs in exchange for their talent. For example:

- In 2000, EMI became the first major label to license its catalog to the online subscription streaming service Streamwaves, and in 2001 EMI became the first label to license to a digital music service, PressPlay without demanding an equity interest in the service. UMG did not sign a deal until a full two years later, which in the fast moving pace of the Internet economy is practically a lifetime. In fact, by the time UMG signed on with Streamwaves in June 2002, EMI had already entered into nine different digital download deals with digital distribution companies like MusicNet, Ecast, and Liquid Audio.

- In 2007, EMI became the first of the major labels to offer digital downloads through the iTunes music store without digital locks on the files. This made the files much easier to use and listen to on a variety of devices and was very popular with consumers. It is worth recalling that Apple’s CEO Steve Jobs, arguably one of the most innovative individuals in modern times, called for the removal of DRM in an open letter to the recording industry and accurately predicted an increase in investment and innovation in digital music. It was not until the following year that the remaining major labels followed EMI’s leadership.

- In 2009, EMI was the first major label, with the band Depeche Mode, to offer an iTunes Pass, a digital music product similar to a deluxe CD package with additional limited edition materials included. Later, EMI was also one of the first labels to sign with Project Playlist, Spotify, and Apple’s iTunes Match.

- EMI has launched OpenEMI, a partnership with The Echo Nest, which allows application developers to access parts of the EMI Music catalog to develop new ways to distribute music. In addition to providing startups and developers API access to content, EMI acts as a liaison between developers and recording artists, holds weekly calls with developers, and requires no advance royalties or flat licensing fees application makers. Developers and EMI split profits 40/60, with EMI distributing its share to the appropriate rights holders. Notably, EMI has been the only major label to launch this type of open API initiative and it is questionable if this project would even continue under UMG ownership given its own history of resisting innovation.
New Digital Distribution Services Benefit Consumers

EMI’s leadership in the industry has helped promote the growth of digital music services, which has benefited both musicians and audiences by offering new opportunities for artists to create, promote, distribute, and monetize their works. Digital technology lets consumers choose when and where they want to enjoy music, and enables consumers to purchase music at the click of a button. Innovative new digital services also decrease the cost of manufacturing and distribution, which in a competitive marketplace would be passed on to consumers as cost savings.

It is no surprise that digital distribution services are increasingly popular with consumers. They give users more flexibility in choosing when and where they will listen to music, and often add new features and functionalities past what a typical AM/FM radio or stereo could do. Consumer demand for these new services has grown significantly as the average amount of time that an active user spent using music apps alone increased 72% between October 2011 and May 2012. In one recent Nielsen survey, 72% of consumers choose either online PC purchases or mobile purchase as their preferred way to buy music. Those surveyed indicated those purchases were easier and more convenient than in-store purchases.

When record labels and other copyright owners are willing to explore new digital distribution technologies, new services that benefit both consumers and artists enter the marketplace. Several new digital music services demonstrate the creative new offerings that can arise if record labels feel competitive pressure from rival labels to find new avenues to reach consumers:

- **Deezer**. Deezer is a web-based music streaming service, similar to Spotify. This past May, Deezer launched Open Deezer, offering open access to its API for developers to create new music streaming services. Even in the short time since the API has been launched, Deezer has launched partnerships with social networks (for example, Facebook, Twitter, and last.fm), mobile telephone services (Orange, Belgacom, and T-Mobile), high-end hi-fi systems manufacturers (Sonos and Logitech), and automobile industry manufacturers (Nissan and Parrot). Deezer encourages new apps by rewarding developers whose apps lead to new Deezer subscribers, and by hosting hackathons. Unfortunately, neither Deezer’s core service nor any of its new applications can be used by U.S. consumers because Deezer does not have the necessary licensing for the U.S.

When Deezer’s COO and CFO Simon Baldeyrou was asked last week about why Deezer has not brought its services to the U.S., one of his first responses was that “[t]he price to enter the market is very high.” Deezer has previously noted that “being able to negotiate correct deals with the labels” is among the top factors

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slowing Deezer’s entry into the US market despite having enjoyed success in 81
countries to date.

- **Spotify.** Last November, music streaming service Spotify announced that it would
be granting developers access to its music library by way of an app framework.
This initiative has resulted in several exciting new apps, like Songkick, which
suggests upcoming concerts to users based on their music catalog, Soundrop, a
social radio station app, or Pitchfork’s music app, which lets users listen to
albums and songs while they read Pitchfork reviews of the music. Spotify has also
begun launching branded apps with non-music partners like McDonalds and Intel,
opening a new potential revenue model for artists in digital distribution.

Currently, the United States is either a late adopter or non-adopter of these new
digital music services. If the merger between UMG and EMI were to proceed, it would
only exacerbate that decline and more of these businesses will start overseas rather than
here at home. Any digital music service that depends upon a music library of substantial
breadth and depth, such as Spotify or the iTunes music store, will fail if it cannot offer a
critical mass of popular music to consumers. The success of these outlets will affect other
distribution platform developers as well as consumers looking for easy, reasonable access
to music.

**New Digital Distribution Services Benefit Artists**

In addition to offering innovative new services for consumers, digital distribution
services give artists more control over their own careers. These new services make it
easier for musicians to bring their works to market without relying on a record label to
handle marketing, promotion, and distribution. For example, while it was traditionally
near-impossible for musicians to convince a large record store to carry their albums
without being signed to a record label, unsigned artists can now use the iTunes
distribution service to sell copies of their recordings to the public. Musicians often
distribute their music through an aggregator like CD Baby or Pure Play Music, which
help artists with physical distribution, digital distribution, and music licensing. Artists can
use these powerful distribution technologies to reach diverse audiences while maintaining
control over the timing, length, and musical content of their works.

New digital distribution services eliminate artists’ need for a middleman to reach
their fans. Advances in recording technology allow a musician to make high quality
recordings without a recording studio. New online social media platforms enable artists
to promote their work and develop relationships with fans without a record label’s
marketing department. Finally, online distribution tools and platforms allow artists to
reach users via their own websites or on new platforms and distribute their music to fans
directly. An artist may still decide that she would prefer to “hire” a record label to
perform those services in exchange for copyright ownership and a large chunk of future
royalties, but digital disintermediation gives the artist a meaningful choice between a
record label and an independent career.
Digital technology also increases efficiency in distribution and benefits consumers by increasing their access to music products and the ease with which they can enter into transactions with artists. For physical products, a large portion of the cost of a good is the costs of manufacturing the good. Digital technologies dramatically lower these costs—after all, an mp3 is much less costly to make, transmit, and store than a vinyl record, cassette tape, or even a CD. As a result, consumers will theoretically enjoy lower prices in procuring recorded music and more flexibility in how, when, and where they listen to it. However, the dominant physical firms—here, major record labels—have a strong incentive to thwart this trend to enjoy continued control and higher profits.

Digital technology opens an entire new world of options for musicians as they decide how they want to make and share their music. New development and distribution services empower musicians to choose how they will shape their careers and help musicians be more responsive to audience demand for their work. Musicians may still choose a more traditional, transaction-based outreach and distribution model, or they may choose to build deeper relationships with their fans or experiment with new distribution methods. Each strategy presents different advantages and challenges, and the right choice will depend upon the unique position of each individual artist. By giving musicians more options from which to choose, the advent of digital music distribution services increases musicians’ ability to craft artistically and financially successful career models. Empowering musicians subsequently benefits audiences, who will enjoy new ways to discover, access, experience, and interact with music.

Digital distribution services do not just enable artists to pursue new business models, but also new business principles. Major labels traditionally pursue mass-market promotion strategies using established distribution methods. This strategy can be an effective way to be heard by a large audience, but in the process the artist may sacrifice building stronger relationships with her fans and also takes the risk that she will not receive as much attention from the label when she is only one of thousands of signed acts. If the artist builds a career without signing to a major label, she may choose to use a more relationship-based business model—building stronger connections with a (at least initially) smaller audience, and letting fans help write the narrative of the artist’s career. Importantly, neither one of these options is inherently better than the other—the point is that new digital music services give artists a choice.

A Combined UMG/EMI Would Have the Power to Prevent or Control New Digital Music Services to the Detriment of Consumers

Digital music services often depend upon the cooperation or collaboration of the record labels that own the relevant sound recording copyrights or the publishers that control the musical compositions. As audience demand currently turns to a streaming, cloud-based model, new distribution services will have trouble launching without a major label willing to be the first to grant licenses, and ultimately may never succeed if a single major label can withhold 41% of the recorded music market even after other labels have started working with the service. Even in today’s marketplace, a major label can wield sufficient power to demand that potential new digital music services pay the label hefty
advances and a high percentage of future revenue, or give the record label an equity stake in the new company. A combined Universal/EMI entity would only be able to exert even more control over new music services.

The proposed merger would dramatically increase the UMG/EMI’s control over sound recordings of popular music—both current and catalog albums—to which competing distribution models must have access to succeed. For example, a combined UMG/EMI would control six out of the top ten best-selling albums of all time.\(^4\)

By virtue of its dominant market share of 41%, the post-merger UMG/EMI would be able to exert its market power over nascent digital distribution platforms and could either license its must-have catalog on onerous terms or thwart the success of the service by withholding its catalog altogether. The threat that this merger poses to new competition in the recorded music marketplace only magnifies concerns raised about the anticompetitive effects of the merger under traditional antitrust analysis.

Moving forward, a post-acquisition Universal would be in a position to further its dominance by withholding licenses for its recorded music and music publishing rights. After UMG acquires EMI’s recorded music division, it would control 41% of all recorded music sales in the U.S.—more than twice the 20% share of Warner Music Group, the third-largest label in the market.\(^5\) After the acquisition, the joint entity would control the recorded music rights and/or at least some portion of the music publishing rights to some of the most popular music in today’s market, including 68 of the Billboard Hot 100 titles for calendar year 2011.\(^6\) This sort of control would put Universal in a position to “make or break” any new service all by itself, allowing it to hamper innovation and/or demand exorbitant terms and conditions. As a result, consumers must either miss out on potential new services or pay excessive fees for those services.

Similarly, Sony/ATV Music Publishing’s acquisition of EMI Music Publishing would give it a significant blocking position in music publishing worldwide.\(^7\) If combined, the Sony/EMI publisher would control over 32% of music publishing revenues worldwide, making the combined entity 40% larger than its nearest publishing competitor, Universal, and more than twice the size of Warner’s publishing operations.\(^8\) Here in the U.S., it would hold at least some portion of the publishing rights to 64 of the

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\(^5\) Alice Enders & Ben Rumley, *EMI: The Game of Music Chairs Continues*, ENDERS ANALYSIS at 6 (Dec. 7, 2011). These numbers include sound recordings owned by independent labels or musicians but distributed through one of the major labels. To the extent that UMG’s distribution contracts with smaller labels allow it to set (or refuse to set) prices and rates with digital distributors for those labels’ recordings, those contracts increase UMG’s leverage over digital distributors and should be considered here. In turn, UMG’s increased control over digital distribution will allow it to demand a higher percentage of sales and licenses from the smaller labels in its general distribution agreements.


\(^7\) *Music & Copyright*, INFORMA TELECOMS & MEDIA, 3 (Mar. 23, 2011) (estimating a 19.7% music publishing market share for EMI and a 12.5% market share for Sony).

\(^8\) *Id.*
Billboard Hot 100 titles for calendar year 2011, including titles for which the recording rights are currently held by its competitors. Moreover, it would control the recorded music rights and/or at least some portion of the music publishing rights to 79 of the Billboard Hot 100 titles for calendar year 2011.

If both the UMG/EMI record label merger and Sony/EMI publisher merger are approved, UMG and Sony’s combined sound recording and composition catalogs would give them enormous leverage over a nascent digital music service. In essence, the two majors’ whims would control the emergence of new distribution options for the entire industry. Digital services that do not require performance rights or non-statutory mechanical rights in music publishing would still come up against Universal, as the dominant player in recorded music, while services requiring performance rights licenses or non-statutory mechanical rights licenses would need to deal with both Universal and Sony, on each company’s own terms, in order to launch a viable service. Access to the content of the majors remains indispensable to building new distribution models. It is not feasible to succeed on the basis of unsigned artists alone. The concentration of control of albums in the hands of a dominant player in a highly concentrated market poses a severe threat to competition and dynamic innovation in this space. As the majors gain greater leverage, alternatives and artists lose out.

The proposed merger would also likely lead to a net loss of jobs in the U.S. recorded music sector. While UMG has not publicly announced its plans to cut jobs post-merger, it stands to reason that the combined label would eliminate redundant positions, particularly for departments like physical distribution and licensing that do not need duplicate departments elsewhere in the same label. Past experience supports this; for example, the Seagram/Polygram merger resulted in 3,000 job losses.

A Combined UMG/EMI Would Harm Independent Labels and Unsigned Artists

By leveraging its 41% market share against digital distributors, a post-merger UMG-EMI record label could stifle the development of services that would help independent labels or unsigned acts compete against the major labels. With the advent of digital platforms, many of the services that set major record labels apart from their smaller competitors are becoming irrelevant. A major label’s ability to get the right consultant to convince a radio programmer to play a new release on the air is simply not as valuable in a world where more and more consumers use online radio services like iHeartRadio, Pandora, and Songza. Major labels’ relationships with brick-and-mortar stores are not as useful when so many sales are made online, and services like CD Baby help independent artists promote and distribute their works. A major label’s special connections to promote an album are less necessary now that an artist can build a fan base using social media or online advertisements. Finally, artists are increasingly willing to record their own songs using new technology rather than wait for a major label contract to release their first LP. Although these developments are obviously disruptive to

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10 Id.
the more traditional major labels, they are a welcome boon to independent labels and unsigned artists, who are for the first time enjoying a much more level playing field than the music business has ever seen.

However, if the combined UMG-EMI entity can undercut the success of a new digital music platform by withholding 41% of the market from that platform, it may be able to maintain its market dominance through anticompetitive conduct rather than innovating and competing against new market entrants. If a digital platform never launches because it could not attract enough users with only little more than half of the most popular music, an independent label could never take advantage of that platform to promote its artists head-to-head against major label artists.

A dominant major label could also license its copyrights to a new digital distributor, but demand equity in the distributor, payments in excess of its true market share, burdensome advance royalty payments, or exclusivity in return. For example, Beyond Oblivion, a digital music service founded in 2008 and backed by News Corp. and Allen & Co., aimed to provide users with a nearly unlimited selection of music on devices that held Beyond Oblivion software. The service filed for bankruptcy in late 2011 before it had even launched. Notably, bankruptcy proceedings revealed that Beyond Oblivion owed outstanding debts of $50 million each to Sony Music Entertainment and Warner Music Group—an astonishing figure for a service that was never actually used by a single customer. These kinds of high advance royalties can hinder a digital startup from launching a successful and sustainable product. They also discourage investors, who must shoulder higher levels of risk for any digital music distribution service that requires direct licensing from record labels.

The sustainability of independent labels benefits artists, either those who decline to partner with a major label or those who seek to develop their career to make themselves more attractive to a major label. For example, Justin Bieber likely would not have been able to become the phenomenally successful recording artist he is today if digital platforms and independent labels had been squeezed out of the market. Bieber’s career began when his mother posted videos of him singing (unlicensed) covers of R&B hits on YouTube. Bieber’s videos caught the attention of talent manager Scooter Braun, and he was soon signed to the independent label Raymond Braun Media Group (RBMG). Bieber later released his albums through the Island Def Jam Media Group, a label owned by UMG, but he was initially discovered and guided into the music business via YouTube and an independent label. Without unaffiliated platforms and smaller labels, similar break out stars may never reach their audience.

But the progress of Justin Bieber’s career, although unusual in magnitude, is not so different in kind from the development of every musician’s career. Whether they hope for a contract with a major label or independent label, or plan to never sign to any label, musicians develop their skill and talent by creating more, playing more, and reaching more fans. Today, that process includes using new digital platforms in addition to practicing at home, playing small venues, and making DIY recordings to give to fans or
A&R representatives. These digital platforms are a necessary part of the development of many of today’s musicians.

Rather than Innovate UMG Has Opted to Consolidate and Litigate

In reviewing this proposed merger, the antitrust authorities cannot ignore UMG’s past conduct and the likely negative impact on innovation. UMG has demonstrated an adversarial approach to new online services that might disrupt the major labels’ current business models and has focused heavily on consolidation to gain market power.

For example, Universal sued the video site Veoh early in its creation for copyright infringement. Despite the fact that Veoh was lawful and ultimately won in court, the litigation bankrupted the company and hamstrung its potential. This pattern of litigation rather than innovation continues unabated today. Last year Universal was the first of the major labels to sue the streaming music service Grooveshark, and Universal sued the streaming service Deezer in France after the company refused Universal’s demand that it limit its freemium tier to five consecutive songs. Luckily, the French courts agreed with Deezer, holding that Universal’s behavior was “an abuse of a dominant position.” In 2006, Universal sued MySpace for its users’ copyright infringement, and even brought a suit against Grouper.com, which was owned by fellow major label Sony.

Instead of meaningfully working with innovative new digital music services, Universal has focused on a strategy of acquiring and consolidating with other record labels. Universal has bought Geffen Records, DGC Records, Universal Republic Records, Univision Music Group, Impulse! Records, and V2 Music Group, to name just a few. In 1998, Universal’s parent company Seagram also bought and merged the PolyGram label, which itself had already purchased Island Records, Interscope Records, Def Jam Recordings, Motown, Mercury Records, Mercury Nashville, Verve Records, and Polydor Records, among others. Seen in this light, Universal’s bid for EMI is just one more step in a concerning decades-long trend of consolidation in the recorded music business.

As a result of its already dominant position in the market, the times when UMG has struck licensing deals with new services has included terms that impaired competition. For example, when UMG licensed its catalog to wireless service provider Reliance Communications, it did so on an exclusive basis, thereby preventing any substitute service from entering the marketplace that would give consumers a choice between services.

The Merger Fails Under Traditional Antitrust Analysis

The antitrust laws are intended to protect innovation and competition, and to prevent firms from using their market power to arbitrarily raise prices for consumers. Traditional antitrust analysis shows that the UMG-EMI merger contains significant competitive harms, particularly in light of the merger’s potential effects on the
development of new digital music distribution models. The merger must therefore be scrutinized closely and its harms must be remedied in order to preserve a competitive, productive music distribution market.

The post-merger market share of the combined UMG/EMI entity would give it the power to distort the development of digital music distribution models or even determine the fate of new digital music services. UMG and EMI's combined market share of 41% would likely give it the power to veto emerging distribution models, and would certainly empower the combined entity to lead other record labels in doing so. With a post-merger three-firm market share of 90%, and with one or two companies following the lead of the dominant firm—here, UMG/EMI—the market would be vulnerable to anticompetitive harm resulting from conscious parallelism.

The Merger Guidelines

The recently-updated joint Department of Justice/Federal Trade Commission Merger Guidelines begin evaluating proposed mergers by analyzing concentration in the relevant markets, as measured by the Hirschman-Herfindahl Index (HHI). If a proposed merger would increase concentration in the market in a way that significantly increases the market power of the post-merger firm, then the merger warrants scrutiny. The threshold levels of concentration that demand scrutiny have recently been raised in the Merger Guidelines, making it all the more important that mergers that exceed the levels specified in the Guidelines be examined and remedied.

Under the revised Merger Guidelines, a moderately concentrated market is defined as a market that exhibits an HHI between 1,800 and 2,500. A market with an HHI below 1,800 is considered unconcentrated, and a market with an HHI above 2,500 is considered highly concentrated. To give a frame of reference, an HHI of 2,500 is the equivalent of a market containing four equal-sized firms, while an HHI of 1,000 is the equivalent of a market containing ten equal-sized firms.

The Merger Guidelines recommend different levels of scrutiny of a merger based on the pre-merger level of market concentration and the extent to which the merger would increase concentration in the market. Mergers that will increase the HHI by more than 100 points and result in moderately concentrated markets potentially raise significant competitive concerns and often warrant scrutiny. Mergers that will increase the HHI by 100 to 200 points and result in highly concentrated markets potentially raise significant competitive concerns and often warrant scrutiny. Mergers that will increase the HHI by more than 200 points and result in highly concentrated markets are presumed to be likely to enhance market power.

The UMG-EMI Merger Raises Significant Competitive Concerns

If allowed, the UMG-EMI merger would create levels of market concentration that raise “significant competitive concerns,” and would thus warrant scrutiny from the antitrust authorities. Much like the failed proposed merger between AT&T and T-Mobile
last year, this merger would also reduce the number of dominant firms in the marketplace from four to three.

When measured by record label revenues, this merger would increase the HHI of the recorded music market by over 500 points (more than five times the trigger under the Merger Guidelines), moving the market from unconcentrated to moderately concentrated.

When measuring only the market for albums, which is the largest single source of record label revenue, the levels of market concentration are even worse. For albums, the merger would increase the HHI of the marketplace by 1,000 points, moving the market from moderately concentrated to highly concentrated. This is five times the level at which the Merger Guidelines state that a merger will be “presumed to be likely to enhance market power.”

Based on 2010 year-end figures, the four major record labels account for almost 90% of recorded music sales in the U.S. UMG is the largest company, with a share of 30.8%, followed by its nearest competitor, Sony (at 28.0%), then Warner Music Group (WMG) (20.0%), and EMI (10.2%). This leaves only an 11.0% market share for independent labels. The combined UMG/EMI entity would control 41% of the market, and the three-firm concentration ratio would reach almost 90%. This situation raises serious concerns that the top three labels will coordinate or engage in conscious parallelism that reinforces the lead of the dominant firm.

Other aspects of this merger only increase concerns under antitrust analysis. The top four to six firms in the market have remained remarkably stable for the past 25 years, despite an unprecedented technological upheaval. This kind of stability raises concerns

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12 *Id.*
that the dominant companies have entrenched themselves and that barriers to market entry prevent new companies from competing with the incumbent labels. As discussed earlier, these particular labels have a history of anticompetitive, anti-consumer conduct that resulted in two settlements less than ten years ago.

Lastly, EMI is not a “failing firm” under antitrust analysis, and so the antitrust authorities cannot permit anticompetitive harms that would otherwise be prevented by antitrust law. A failing firm must be in imminent danger of financial failure and unable to reorganize under Chapter 11 of the Bankruptcy Act, and the firm must have made good-faith efforts to find a viable alternative that would avoid anticompetitive harms. In recent years EMI has seen very stable revenues, and EMI’s profit margins have risen steadily from 5.6% in 2007-08 to an industry-leading 17% profit margin in 2010-11.13

**Piracy Does Not Discipline the Major Labels from Raising Prices**

Claims that the piracy will prevent anticompetitive harms should the merger be consummated are belied by empirical analysis of the prevalence of infringement in the music business, and by the major labels’ own prior conduct. Last year alone, consumers spent almost $2.5 billion on digital music products, showing a strong desire by consumers to access music legally. If consumers today are willing to pay an average of $10.40 per digital album, why would they suddenly resort to piracy if the price went up to $11?

Piracy’s inability to discipline the major labels is evident from the majors’ behavior. After all, piracy exists today, but major labels are consistently resistant to new digital distribution models that are responsive to consumer demand. The major labels have also managed to raise prices for some singles on iTunes from $0.99 to $1.29, a move they would not be able to make if piracy was preventing them from raising prices.

The major labels’ past behavior also shows that piracy does not stop the major labels from raising prices, even to anti-competitive levels. In the mid-1990s, the major labels adopted two practices designed to resist innovation and prop up profits at the expense of consumers. The labels entered into a price-fixing scheme to maintain high album prices despite their dramatically decreased costs of production for CDs. They also eliminated the sale of singles, even though previous sales had indicated significant consumer demand for singles, to force consumers to purchase more expensive (and more profitable) albums. The major labels eventually settled antitrust lawsuits brought by the Federal Trade Commission and state Attorneys General, ending the anticompetitive schemes. Shortly thereafter, the sales of singles skyrocketed, from 8.4 million singles in 2002 to 1.2 billion singles in 2010, and record labels once again began to respond to downward pricing pressure. It is important to remember that these antitrust violations occurred at a time when the market was less concentrated than it is today. If piracy had created the downward pricing pressure that merger proponents claim, those price fixing

schemes would have been unprofitable because they would have driven more consumers to infringe.

As Public Knowledge and the Consumer Federation of America examined in depth in our recent white paper on the UMG-EMI merger, studies indicate that piracy has had much less impact on the recorded music market than the merger proponents now claim.\textsuperscript{14} Indeed, for some demographics, unauthorized downloads act as promotional materials and actually increase legal purchases of music. Studies also indicate that the most efficient way to decrease copyright infringement is to increase the availability of reasonably priced legal alternatives—exactly what UMG-EMI will be less motivated to do if the merger is approved.

**Conclusion**

Competition among production and distribution intermediaries in the music industry ultimately gives more choice to musicians and leads to better market offerings for consumers. Competition increases the diversity of choices for consumers, empowering consumers to choose the services that best fit their needs at the best price. If one or two major labels obtain enough influence to stifle the development of new digital music services, those services never will be able to gain traction in the marketplace, and potential competitors will fall, not on their merits, but based on the service’s inability to strike a deal with an inordinately powerful supplier. As a result, both musicians and audiences will suffer for lack of innovative competitors in the online music service marketplace.

We therefore are concerned that allowing this transaction to proceed not only will thwart burgeoning digital music innovations, but will also potentially drive up prices and minimize choice for consumers. The merger must therefore not be allowed to proceed.

\textsuperscript{14} Mark Cooper and Jodie Griffin, *The Role of Antitrust in Protecting Competition, Innovation and Consumers as the Digital Revolution Matures: The Case Against the Universal-EMI Merger and E-Book Price Fixing* (June 2012).