MUSIC INDUSTRY CONSOLIDATION: THE LIKELY ANTICOMPETITIVE EFFECTS OF THE UNIVERSAL/EMI MERGER

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Executive Summary

Universal Music Group's (Universal or UMG) proposed acquisition of EMI's recorded music division has raised substantial antitrust concerns. For example, it is well documented that the transaction would reduce the number of major music labels in the U.S. recorded music market from four to three. According to data provided by The Nielsen Company and Billboard, this would give the merged firm a 40% market share.[2] It would also give the merged firm 51 of the Billboard Top 100 titles for the calendar year 2011.[3] Perhaps of equal or greater concern, the transaction is likely to negatively impact innovation incentives in an industry that is currently being shaped by nascent platform competition. There is a substantial risk that, post-merger, Universal would have the ability and incentive to leverage its extensive music catalogue to restrain entry of new digital service providers, likely leading to less innovation and fewer choices for digital music listeners. After a review of publicly available information, the American Antitrust Institute (AAI) believes that the transaction is likely to lead to unilateral and

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[2] *See The Nielsen Company & Billboard's 2011 Music Industry Report*, (January 5, 2012), *available at* http://www.businesswire.com/news/home/20120105005547/en/Nielsen-Company-Billboard%E2%80%99s-2011-Music-Industry-Report.

[3] *See Charts, Year End Charts, Hot 100 Songs*, Billboard.biz (2011), *available at* http://www.billboard.biz/bbbiz/charts/yearendcharts/2011/hot-100-songs.

coordinated anticompetitive effects, which are unlikely to be cured by divestitures or behavioral relief. For reasons discussed below, we urge the Federal Trade Commission (FTC) to enjoin the transaction and preserve EMI as a fourth major music label in the already concentrated recorded music industry.

In this white paper, we analyze the likely competitive effects of the transaction by exploring market definition, concentration, innovation incentives, unilateral and coordinated effects, proffered efficiencies, and the feasibility of behavioral or structural relief short of an injunction. We also consider piracy and buyer power as potential offsets to market power. We conclude that neither efficiencies nor other justifications would effectively counteract the harm likely caused to consumers by a Universal/EMI combination and the removal of one major competitor from the market. Therefore, remedies short of an injunction likely would be ineffective. Harm to competition is likely to flow from diminished consumer choice (for both artists and end-user consumers) and diminished innovation. We urge the FTC to consider blocking the proposed transaction.

I. Introduction

Music is intangible and requires a license from its owner any time that it is used.[4] Each piece of recorded music generates two separate copyrights: the copyright in the underlying music composition, i.e. notes and lyrics, and the copyright in the sound recordings, i.e. the work resulting from the fixation of a series of musical or other sounds. The latter copyright protects the way the composition is performed.

The two rights are often held by different owners. Copyrights in songs are usually controlled by a music publishing company, and copyrights in sound recordings by a recording company. Recording companies are responsible for finding, developing and retaining recording

[4] Under current United States copyright laws, the owner of a copyrighted work was the exclusive rights (1) to reproduce the copyrighted work in copies or phonorecords; (2) to prepare derivative works based upon the copyrighted work; (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending; (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly; and (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly. *See* Copyright Act of 1976, Pub. L. No. 94-553, § 106 (1976).

artists and marketing, promoting and selling their recorded music in all formats on all platforms. Major record companies typically participate in both music publishing and recorded music markets. In this white paper, we consider only recorded music.

On November 11, 2011, Citigroup announced the sale of EMI's recorded music division to Universal Music Group for $1.9 billion. Citigroup had acquired EMI, a UK-based, multinational music company, in February 2011 after Terra Firma, a British private equity firm that had purchased EMI in 2007, failed a solvency test and defaulted on its debt.

After recapitalizing EMI's $3.5 billion in debt and reducing it by 65%,[5] Citigroup put the company up for sale. At auction, the main bidders for EMI's recorded music division were Warner Music Group (WMG or Warner), which had made previous offers to EMI and been refused; Vivendi SA, the French media conglomerate that owns Universal; and MacAndrews & Forbes, a holding company controlled by Ronald Perelman.

In the United States, the FTC is reviewing the transaction and issued a second request in February 2012. The European Commission (EC) is also analyzing the transaction, and on March 23, 2012, it launched an in-depth probe. In a statement of objections sent to Universal in June 2012, the EC focused on the impact of a combined Universal/ EMI in the digital music marketplace.[6] In particular, the Commission is concerned that the combined company would wield too much power over the licensing of music to would-be digital services.[7]

Universal is taking considerable steps to guarantee the transaction's clearance by offering to divest valuable assets. In a remedies negotiation with the EC, it initially offered to sell Virgin Records. When this failed to appease European regulators, it upped the offer to include part of EMI's Parlophone label, including Coldplay, but not The Beatles. So far, however, the remedies package applies only to European rights and not to U.S. rights. It is unclear whether the same or a similar package would satisfy the FTC, even if it were to satisfy the EC. Furthermore, in both jurisdictions, enforcers would have to consider whether divestitures could address the harm to innovation incentives that would result from the proposed transaction. This may prove unlikely

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[5] *See* Ed Christman, *Now That Citigroup Has Taken Over EMI, What's Next?*, Billboard.biz (February 1, 2011), http://www.billboard.biz/bbbiz/industry/record-labels/now-that-citigroup-has-taken-over-emi-what-1005017482.story.

[6] *See* Eric Pfanner, *Europe objects to Universal Acquisition of EMI*, The New York Times (July 3, 2012), *available at* http://www.nytimes.com/2012/07/04/business/global/eu-objects-to-universal-acquisition-of-emi.html.

[7] *Id.*

because divestitures are unlikely to re-create a major label. The EC's investigation is expected to conclude by September 27th of this year.

II. Market Definition

A. The Relevant Product Market

At its broadest, the relevant product market for purposes of this transaction is likely to be defined as "recorded music services," which includes talent scouting and overseeing artistic development (A&R), marketing, and the promotion and sale of recorded music. Although its conclusions are not binding in the U.S., the EC recognized this "recorded music services" market in its analysis of Sony's 2004 acquisition of BMG.[8] Moreover, the recorded music divisions of the various record labels are generally known to compete in this market in providing at least this combination of services.

However, narrower product markets may also be found, and they deserve to be explored. If, for example, a hypothetical monopolist of recorded music services in an individual musical genre could impose a small but significant and non-transitory increase in price without prompting consumers to switch genres, the transaction might have important competitive effects in several individual genres. Universal and EMI together would have a particularly large share of releases in international pop, classical music and jazz, which might cause concerns about unilateral effects in those genres. The parties in Sony/BMG argued that "competition does not take place exclusively in genres" and that "musical tastes are developing constantly, resulting in changing preferences for genres."[9] Enforcers should nonetheless test these arguments under the changed circumstances of the transaction currently under review.

Another question concerning the relevant product market for recorded music is whether online and offline (physical sales) markets should be treated as analytically separate. Although it can be argued that digital and physical formats are merely different methods of distributing the same product, the substitutability between the two different methods may prove low. A teenager that is used to buying music on iTunes would probably never consider buying a CD, while a technophobe without an iPod might never consider downloading musical track. In UMG/BMG and Sony/BMG II, the EC found that online and offline formats are two separate markets, and

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[8] *See Sony/BMG*, Case No COMP / M.3333, 19 July 2004.
[9] *Id*., at § 9.

that "there are significant differences between the distribution of recorded music via physical carrier and its online sale."[10]

Online music services include not only downloading services, but also streaming services, which convey a temporary, lesser form of control over a song or album and are therefore difficult to compare to a CD. Moreover, in the physical format, the consumer is acquiring the whole album, with songs both known and liked and unknown or disliked, while online consumers have the ability to download or stream individual songs and create personalized albums.

The cost structure and technical and commercial conditions of the two markets are also very different. In the online market, licenses are negotiated, whereas in the offline market the record company has to procure production and distribution of the physical product.[11] In 2011, digital music sales were larger than physical sales for the first time, accounting for 50.3% of all music purchases in the U.S.[12] If current trends progress and digital music substantially replaces physical sales, the distinction between digital and physical sales may become less important. But for purposes of the present merger, where the overall market is closely divided, the distinction is important.

In conclusion, we believe there is a relevant product market for all recorded music services, which are part of the central activities of record companies. However, the physical and digital markets are likely separate, narrower relevant product markets, as the two markets have different dynamics that are likely to impact the analysis. Although a detailed analysis of individual musical genres as potential relevant product markets is beyond the scope of this paper, we believe the risks of potentially anticompetitive effects in these markets also merit attention.

B. The Relevant Geographic Market

The relevant geographic market for the proposed transaction is likely national. Although the major record companies operate on a global basis, they tend to organize and structure themselves, and set prices and assess consumer preferences, on a country-by-country basis. This

[10] *See* Case No COMP / M.3333 – Sony/BMG, 19 July 2004, §22.
[11] *Id.*, § 23.
[12] *See supra* note 2.

is true not only for physical sales, but also for digital sales, notwithstanding the ease with which some might expect the Internet to accommodate cross-border commercial transactions.

National geographic markets are more plausible than a global market for several reasons. First, online music licenses are granted only on a national basis. As a result, distributors must usually warrant that their customers are residents of a specific country, and they cannot sell products outside national borders. In addition, as the EC noted in Sony/BMG II, licensing agreements in different countries may differ in terms of content, particularly with respect to pricing and usage rules.[13] For all of these reasons, the relevant geographic market for the proposed transaction is likely to be deemed no broader than the United States.

III. Market Concentration

A. The High Likelihood of Consumer Harm Under a Traditional Market Share Analysis

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)[14]

TOTAL ALBUMS (Catalog & Current Titles)			**PHYSICAL ALBUMS** (Catalog & Current Titles)			**DIGITAL ALBUMS** (Catalog & Current Titles)		
	2011	**2010**		**2011**	**2010**		**2011**	**2010**
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%	22.60%
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 Merger

[13] *Id.*, at § 31.

[14] Reproduced from The Nielsen Company & Billboard's 2011 Music Industry Report, (January 5, 2012), *available at* http://www.businesswire.com/news/home/20120105005547/en/Nielsen-Company-Billboard%E2%80%99s-2011-Music-Industry-Report.

Guidelines.[15] 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 would take the market from "moderately concentrated" to "highly concentrated" under the Guidelines,[16] and at 2,782 HHIs, (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."[17] Structurally, at least, the transaction is therefore presumptively anticompetitive by a wide margin.

When considering separate physical and digital relevant product markets, the concentrating effect of the proposed transaction does not change. In the physical market, the transaction remains a 4-3, with HHIs going from 1943 to 2510, an increase of 557. In the digital market, the transaction likewise remains a 4-3, with HHIs going from 2340 to 2917, an increase of 567. 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. An analysis of the concentrating 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 enforcers.

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."[18] But the Guidelines also stress that "[t]he 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.[19] Market shares in the recorded music industry have been remarkably stable from 2006-2012 despite a massive industry transformation that drastically altered distribution and pricing

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[15] U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, *available* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf. 11 (August 2010)
[16] *Id.*
[17] *Id*.
[18] *Id*.
[19] *Id*.

practices and caused revenues to plummet during the lead-up to this six-year period.[20]

Notwithstanding 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 record company has seen its market share in total album sales increase or decrease by more than 4.32% in six years' time.[21] 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% during that time.[22]

TABLE 2: 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)[23]

	2011	**2010**	**2009**	**2008**	**2007**	**2006**
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%
WMG	19.13%	20.01%	20.55%	21.38%	20.28%	18.14%
EMI	9.62%	10.18%	9.20%	8.97%	9.37%	10.20%
OTHER	12.11%	11.02%	11.47%	12.83%	13.48%	12.61%

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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[20] *See* David Goldman, *Music's Lost Decade: Sales Cut in Half*, CNN Money, http://money.cnn.com/2010/02/02/news/companies/napster_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).
[21] *See infra* Table 2.
[22] *Id.*
[23] Compiled using the Nielsen Company & Billboard's annual music industry reports for the years 2007-2011. *See e.g.*, The Nielsen Company & Billboard's 2011 Music Industry Report, January 5, 2012, *available at* http://www.businesswire.com/news/home/20120105005547/en/Nielsen-Company-Billboard%E2%80%99s-2011-Music-Industry-Report. Prior to 2010, the report was produced solely by Nielsen. Prior to 2009, SME was referred to as "Sony/BMG" in Nielsen annual reports.

TABLE 3: 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)[24]

	2011	**2010**	**2009**	**2008**	**2007**	**2006**
UMG	28.35%	27.47%	26.92%	27.80%	22.98%	27.35%
SME	25.36%	24.18%	24.21%	21.30%	22.86%	24.00%
WMG	19.91%	22.60%	22.80%	23.48%	22.98%	23.29%
EMI	10.00%	10.71%	9.92%	10.91%	10.80%	9.99%
OTHER	16.37%	15.03%	16.14%	16.50%	15.67%	15.37%

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)[25]

	2011	**2010**	**2009**	**2008**	**2007**	**2006**
UMG	32.97%	33.30%	32.99%	31.77%	33.75%	32.96%
SME	26.21%	25.28%	24.95%	23.54%	23.19%	25.66%
WMG	17.74%	19.58%	20.23%	20.87%	20.50%	19.69%
EMI	8.26%	8.36%	7.85%	8.36%	7.74%	7.93%
OTHER	12.97%	12.51%	13.42%	15.35%	14.83%	13.75%

That market shares have remained stable over the last six years is not conclusive evidence that concentration will cause harm to consumers,[26] but it should raise concerns. First, it tends to confirm that 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

[24] See *supra* note 14.
[25] See *supra* note 14.
[26] 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." *See supra* note 15, at § 5.3. 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. (emphasis added).

meaningfully in either the digital segment or overall. It is also inconsistent with the statements of Martin Mills, Founder and CEO of Beggars Group, which represents thousands of independent artists worldwide. Mills suggests that the contention that independent labels exert significant constraints on major labels is "as far from reality as it can be."[27]

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.

B. The High Likelihood of Consumer Harm Under Alternative Measurements of Market Share

The traditional method for measuring market share in the recorded music industry – the Nielsen "SoundScan" methodology – assesses market share by measuring both ownership and distribution of music rights. This is because major labels often distribute not only their own recorded music, but also recorded music owned by independent labels ("Indies") pursuant to distribution agreements. Insofar as these distribution agreements convey control of Indie-owned music rights by major labels, Nielsen has relied on this information to depict the major labels' reach relative to their grasp.

However, in seeking to gain approval for the transaction, Universal has argued that market shares should instead be measured strictly by reference to ownership, without regard to distribution rights. Accepting this change would raise the collective market share of the various fragmented, independent labels from 12.5% to 31.23%, and it would also alter other figures depicted in the above charts accordingly.[28]

Even if Universal could offer a viable justification for departing from the traditional methodology, the re-characterized market shares under its own test would fail to survive scrutiny. Defining market shares only in terms of ownership, so that Indies collectively have a

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[27] *See The Universal Music Group/EMI Merger and the Future of Online Music: Hearing before the Senate Antitrust, Competition and Consumer Rights Subcommittee,* 112th Cong. 6 (June 28, 2012) (Statement of Martin Mills, Founder and CEO Beggars Group) http://www.judiciary.senate.gov/resources/transcripts/upload/062112RecordSubmission-Kohl.pdf.

[28] *See* Rich Bengloff, *A2IM Disputes Billboard/SoundScan's Label Market-Share Methodology*, Billboard.biz (March 3, 2011), *available at* http://www.billboard.biz/bbbiz/industry/record-labels/a2im-disputes-billboard-soundscan-s-label-1005057292.story.

higher market share than any single major, does nothing to alter the balance of power in the industry. This is because the fragmented character of the Indies prevents them from exerting any competitive pressure on the majors. The majors' "must have" repertoires combined with their global reach advantage and vertical integration would continue to guarantee favorable terms, among other things. Moreover, the majors would remain indispensable in the launching of online services. The significance of this fact is discussed in more detail below.

Universal also suggests that the otherwise neutral, third-party market share data unfairly casts it as too powerful by arguing that Merlin, a global rights agency, operates as a "virtual fifth major" in the recorded music industry.[29] Merlin, however, negotiates and licenses digital rights in the recorded music market only on behalf of the independent labels that are its members. Significantly, it does not negotiate licenses with iTunes and Amazon, which instead negotiate directly with the labels. In the United States, Merlin's members' market share in digital licensing services has been reported at around 10%.[30]

Regardless of whether Merlin can be considered a "virtual fifth major" in perhaps some limited sense, the designation is unpersuasive for purposes of this analysis. First, Merlin is not a record company, but rather performs only one aspect of the record company activities – licensing. It is not involved in A&R, promotion, marketing or other recorded music services that the majors offer. Second, Merlin represents independents on a non-exclusive basis, different than majors, and it does not negotiate with all service providers.

Because neither the presence of Merlin nor the concept of ownership-only market shares meaningfully alter the transaction's likely competitive effects, consumer harm appears to be just as likely under both traditional and alternative measures of market share. Moreover, the parties to the transaction have not emphasized still another alternative measure of market share, which would take place under a "control shares" test. Under a control shares test, which would account

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[29] *See* Lucian Grainge, *Written Submission of Universal Music Group before the Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights,* (June 21, 2012), http://www.judiciary.senate.gov/pdf/12-6-21GraingeTestimony.pdf.
[30] *See Merlin Agrees $Multi-Million Copyright Infringement Settlement with XM,* Merlinnetwork.org, (November 4, 2011), *available at* http://www.merlinnetwork.org/1302796160_en_gb/

for the so-called negative rights in songs held by majors, the concentrating effect of the transaction – and consumer harm – could be even worse.[31]

C. The Music Industry's Unique Susceptibility to Harm from Concentration

High concentration levels are always a concern in any antitrust inquiry, but as discussed above, they are not always dispositive. Here, however, the effects of further concentration are particularly troublesome, because the music industry is both a "media" industry and a "platform" industry. Recorded music is a media industry insofar as it implicates our core cultural and democratic values, including diversity among literary, artistic and political expressions, and variety among the choices available to consumers. When competition is severely diminished, these values are directly threatened. It is a platform industry insofar as artists, labels and consumers access each other online using networks that incorporate complex digital technologies through which phenomena like network effects and "tipping" may lead to inefficient outcomes.[32] In this context, the effects of concentration can be amplified.

But even if the proposed transaction did not involve a media industry recovering from a digital technology revolution, other serious problems would remain. For example, barriers to entry in the recorded music market appear to be substantial. Supporters of the transaction have argued that the Internet has given artists the power to easily and independently publicize their songs online, but major labels have marketing and promotion teams, press, radio, and TV and financial departments, as well as the ability to provide advances to artists that provide much needed income while they are building their reputations. The labels make an investment in the artists' careers. They also possess essential industry knowledge and expertise.

The global reach of major labels also allows them to distribute music in multiple geographic territories, negotiate with digital distributors, many of which are global operators,

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[31] A control shares test would account for the full power that majors actually enjoy as a result of their ability to prevent certain songs from being licensed. Songs are often performed by more than one artist, and sometimes the composition itself is written by more than one songwriter. Different labels may therefore have control over disposition of the same recorded music rights, and in turn they will share in the licensing rights. When multiple labels jointly control a work, each has the ability to refuse to license a composition. Known as "negative" rights, the ability to refuse to license may translate to more market share than the major possesses under a sales or revenue measurement. For example, a digital service provider that cannot reach an agreement with one major will not only lose licenses to the titles belonging to that major, but also to all the titles to which the major has partial negative rights.

[32] *See* David S. Evans, *Two-Sided Platforms and Analysis of Single-Firm Conduct,* (September, 2006), http://ftc.gov/os/comments/section2hearings/522292-00012.pdf.

and access media entities throughout the world. The majors also have the leverage to guarantee better terms in licensing agreements, or in agreements with manufacturers, distributors and retailers. Scale thus plays a major role in the music industry and amounts to a significant entry barrier.

III. The Significant Risk of Anticompetitive Effects

A. Coordinated Effects

A merger may enable or encourage coordinated interaction among firms in the relevant market that may diminish competition and, therefore, harm consumers.[33] The Horizontal Merger Guidelines provide that "[a]n acquisition eliminating a maverick firm . . . in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects." Some evidence suggests that EMI is likely to be considered a maverick, particularly in the digital market, because it has been a leader in supporting innovation in the music industry. EMI was in several instances the first competitor to support new digital services and innovative technology entrants with new digital distribution platforms.

EMI was the first company to sell the world's first song offered as a digital download - a David Bowie single in 1996.[34] It was also the first to license to a digital music service that it did not have any stake in.[35] Until then labels had refused to license music to digital music sites that they did not own, at least in part. At that time, labels would license only to digital music subscription services that they had an ownership interest in, and consequently there was no single website with a complete music library. EMI was the innovator that took the first step to a legitimate digital music market.

EMI was the first to drop Digital Rights Management (DRM) on iTunes in 2007. DRM is a class of access control technologies that limit the use of digital content and devices after sale. EMI's CEO of that time, Eric Nicoli, affirmed EMI's goal to boost sales of digital music by

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[33] *See supra* note 15, at § 7.

[34] *See David Bowie, "Telling lies", And The First Digital Single*, Hippies Are Dead Blog (December 6, 2010), http://www.hippiesaredead.com/2010/12/david-bowie-telling-lies-and-first.html.

[35] *See* Penelope Patsuris, *Other Labels Must Follow EMI's Lead*, Forbes.com (October 2, 2001), http://www.forbes.com/2001/10/02/1002emi.html.

"offering consumers the opportunity to buy higher quality tracks and listen to them on the device or platform of their choice".[36]

Likewise, EMI was the first company (with Depeche Mode) to offer an iTunes pass.[37] It was one of the first to sign with Project Playlist[38], Spotify[39] and Apple iTunes Match.[40] And it was the first major to make its entire digital catalogue available for sale in Amazon's new digital music store in the U.S.[41] EMI has been identified as being "at the cutting edge of the rapidly growing digital music marketplace since it released David Bowie's 'Hours' as the world's first ever album to be offered as a digital download in 1999."[42] EMI "has signed agreements with hundreds of digital partners to distribute its music across the globe" and it "continues to facilitate the development of a growing range of new digital business models to enable fans to experience and purchase its artists' output through a number of different platforms …".[43]

Examples of EMI's maverick behavior go on and on. Without EMI in the marketplace, Universal might decide only to sponsor those new innovative digital services that serve its interests. Although other record companies may have similar goals as Universal, they may have different approaches to new technologies. The more companies that are available to sponsor and invest in new services, the more consumers benefit. If the proposed merger between Universal/EMI removes the innovator or maverick firm in the digital distribution space that is

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[36] *See* Charlie Sorrel, *It's Official. EMI and iTunes Drop DRM*, Wired.com (April 2, 2007), http://www.wired.com/gadgetlab/2007/04/its_official_em/.

[37] *See* Michael Rose, *EMI & Depeche Mode Offer First iTunes Pass,* Tuaw.com (February 24, 2009), http://www.tuaw.com/2009/02/24/emi-and-depeche-mode-offer-first-itunes-pass/.

[38] *See* Staci D. Kramer, *Project Playlist Adds EMI Music But No Facebook, Myspace; Still Being Sued,* paidContent.org (March 25, 2009), http://paidcontent.org/article/419-project-playlist-adds-emi-music-but-no-facebook/.

[39] *See* Alex Pham, *Spotify reportedly close to licensing deal with EMI in the U.S.,* Pop & Hiss, The L.A. Times Music Blog (February 2, 2011), http://latimesblogs.latimes.com/music_blog/2011/02/spotify-lands-licensing-deal-with-emi-in-the-us.html.

[40] *See* Greg Sandoval, *Exclusive: Apple near cloud-music deals,* Cnet.com (May 18, 2011), http://news.cnet.com/8301-31001_3-20064155-261.html

[41] *See EMI Music First Major Music Company To Make Its Entire Digital Music Catalog Available For Sale In Amazon.com's New Digital Music Store In The U.S.,* Allbusiness.com (May 16, 2007), http://webcache.googleusercontent.com/search?q=cache:fmnta8yaSrQJ:www.allbusiness.com/services/business-services/4331352-1.html+&cd=6&hl=en&ct=clnk&gl=us#ixzz1owYrKI8W.

[42] *See EMI Music enters into new agreement with Qtrax for ad-supported digital music service,* (June 3, 2008), http://www.emimusic.com/news/2008/emi-music-enters-into-new-agreement-with-qtrax-for-ad-supported-digital-music-service/

[43] *Id.*

willing to sponsor new competing digital distribution platforms, then the merger is anticompetitive as it is likely to cause adverse coordinated effects.

Nonetheless, a merger may give rise to a new maverick that might be able to exert as ample a constraint on the potentially-coordinating group as the prior maverick eliminated by the merger. This defense is known as "repositioning." However, neither Sony nor Warner are likely to replace EMI's position as an innovation maverick in a scenario where one major has enough power to function as a gatekeeper to new platforms, as would be the case here. Even if any of these companies decided to support a new digital service, the service could not successfully last without Universal's sponsorship.[44]

In order to be profitable and successful in the market, new entrants, especially new digital platforms, need a comprehensive offering of music and, therefore, must negotiate with all majors in the market to obtain their licenses that would allow the introduction of the new model. Typically, the new entrant approaches one of the majors first, normally the innovator as seen in the examples of EMI above. The new entrant then presents its ideas in an effort to convince the major to support the introduction of the new model. After one major agrees, the new entrant tries to gain traction in the marketplace and persuade more majors to support its platform. When it gets the support of three majors, the fourth is not in a position to refuse to license.

Currently, the way the market is divided between four main players allows a certain degree of balance and competitiveness. This is especially true in the digital markets, where a new service with three majors has more leverage to convince the fourth to join them. A new model can therefore be accepted with a supermajority of the majors on board; there isn't any major that is big enough to block the new platform by itself.

The concern in a post-merger market is that the removal of one of the majors will in fact create a super major, which will remove the balance in the market by having enough power to block new services. The leverage the majors will have would allow them to block services even before they launch. Therefore, the elimination of EMI, which functions as an innovator and helps balance the dynamics of licensing, threatens to prejudice the industry, specifically with respect to new digital services entrants.

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[44] *See also infra* Part E.

B. Unilateral Effects

The Horizontal Merger Guidelines state that "[t]he elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition."[45] The unilateral effects theory refers to the ability of post-merger firms to raise prices or reduce competition as a result of the removal of competitive constraints resulting from the merger.

In a differentiated products market analysis, we can consider EMI's products as substitutes for Universal's products, meaning that an increase in price by Universal would lead to an increase in the units sold by EMI because EMI would undercut their price and hence sales would be diverted from Universal to EMI. If the mergers occur, there is an added incentive to raise price caused by the merger because an increase in price by the merged company is now more profitable than it was for Universal when they were selling only Universal's product. Universal would be able to obtain additional profits from the increased sales of EMI products that would result when consumers switch from Universal's products to EMI's product.

When musical genres are considered, EMI's songs are Universal's next best choice for a significant number of consumers. Universal and EMI are particularly strong in classical music and jazz. One of Universal's proposed package of divestitures included EMI Classics, supporting the concern of the record company with the overlaps in this musical genre.

However, a unilateral effects analysis in the music market may prove more complicated. Because of the heterogeneous character of music, diversion may not be that simple, and it may be difficult to determine the closest competitor. Because music tastes vary from consumer to consumer, an increase in price may affect each consumer differently.

C. Exclusionary Effects

In addition to unilateral and coordinated effects, the Horizontal Merger Guidelines recognize that "[e]hanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct."[46] The exclusionary effects of the proposed transaction may be substantial because the larger the market shares and the more vertically integrated are the majors, the more likely they are to keep smaller rivals from

[45] *See supra* note 15, at § 6.

[46] *See supra* note 15, § 1.

accessing the best producers and other important upstream and downstream relationships. Moreover, the majors can impose exclusive agreements or more beneficial terms in negotiations with new digital platforms, which they have already been doing.

The elimination of EMI as a competitor increases the incentive and ability of Universal and Sony not only to raise its smaller rivals' costs, but also to effectively exclude competitors from the market by limiting promotional opportunities, shelf space, and other aspects of marketing services. Post-merger, the leading promotional firms would have more access and more negotiating leverage, while smaller competitors, without such bargaining power, will command less attractive terms. In the physical market, for example, the merger would encumber "the space on shop shelves and magazine front covers for less mainstream artists."[47] Independents in particular have expressed this concern.[48] According to Martin Mills of Beggars Group, magazine covers are illustrative:

> Q Magazine has 12 covers a year. If Universal has 50% of the market, it would get six covers a year. But it may use the leverage of its big artists to get its not-so-big artists on the cover, and push its number of covers up to seven or eight, [sic] That means that all the other labels have four to five covers to split between them.[49]

The transaction thus threatens exclusionary effects by narrowing, to the point of foreclosing, marketing and promotional opportunities, which are a key aspect of providing recorded music services.

D. The Merger Threatens to Negatively Impact Downstream Innovation Incentives

Notwithstanding the above, the proposed transaction also threatens to negatively impact innovation incentives among digital distributors, 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,

[47] *See* Glenn Peoples, *Business Matters: Analysis of Martin Mill's Harsh Words on Universal-EMI merger,* Billboard.biz (April 16, 2012), *available at* http://www.billboard.biz/bbbiz/industry/record-labels/business-matters-analysis-of-martin-mills-1006778152.story.
[48] *Id*.
[49] *See* Helienne Lindvall, *Universal's takeover of EMI poses threat to musical diversity,* The Guardian (March 9, 2012), http://www.guardian.co.uk/media/2012/mar/09/universal-takeover-emi-threaten-market.

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 distribution, 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 as discussed above, 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 begin to develop with the backing of any of the four major labels (though perhaps only after the label extracts onerous concessions[50]), 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 withstand the pressure to join for very long. Thus services like iTunes, Spotify, and Amazon's music download 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.[51]

Post merger, Universal would be the sponsoring label nonpareil. The mere perception that a single dominant firm, or three firms with market power consciously acting in parallel, can

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[50] *See* Michael Robertson, *Why Spotify Can Never Be Profitable: The Secret Demands of Record Labels*, GigaOM (Dec. 11, 2011), *available at* http://gigaom.com/2011/12/11/why-spotify-can-never-be-profitable-the-secret-demands-of-record-labels/ (describing contract terms frequently foisted upon digital subscription music services).
[51] Amazon, for example, signed its first music deal with EMI in 2007. *See* Brad Stone, *Amazon to Sell Music Without Copy Protection*, New York Times, May 17, 2007, http://www.nytimes.com/2007/05/17/technology/17amazon-web.html. Spotify signed its first music deal with Sony in 2011. *See* Ben Parr, *Spotify Signs First U.S. Music Deal With Sony*, Mashable Entertainment, Jan. 19, 2011, *available at* http://mashable.com/2011/01/19/spotify-sony-deal/.

leverage access to an essential input would inevitably dissuade rational downstream distribution investors from innovating in new 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. With repositioning unlikely,[52] the two remaining labels would base their own licensing negotiations 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.[53] 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.[54] 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.[55] In January 2011, it finally struck its first U.S. deal with Sony.[56] In February, it reached a deal with EMI.[57] 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,[58] it finally reached terms with Universal in June.[59] Weeks later, it signed with Warner and promptly launched in July.[60] By

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[52] *See infra* Part E.
[53] Spotify.com, What is Spotify?, http://www.spotify.com/us/about/what/ (last visited Aug. 28, 2012).
[54] Ben Sisario, *New Service Offers Music in Quantity, Not By Song*, New York Times, July 13, 2011, *available at* http://www.nytimes.com/2011/07/14/technology/spotify-music-streaming-service-comes-to-us.html/?pagewanted=all.
[55] *Id.*
[56] Ben Parr, *Spotify Signs First U.S. Music Deal With Sony*, Mashable Entertainment (Jan. 19, 2011), *available at* http://mashable.com/2011/01/19/spotify-sony-deal/.
[57] *See* Peter Kafka, *Spotify Signs On EMI for U.S. Launch. At Least One More to Go...,* All Things D (Feb. 17, 2011), http://allthingsd.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.").
[58] Brenna Ehrlich, *Spotify to Cut Back on Free Music*, Mashable, (April 14, 2011), *available at* http://mashable.com/2011/04/14/spotifylimited/.
[59] Peter Kafka, *When Will Spotify Finally Come to the U.S.?,* All Things D (June 10, 2011), http://allthingsd.com/20110610/spotify-signs-universal-music-may-really-get-to-the-u-s-after-all/.

August, the service was already boasting 1.4 million U.S. subscribers.[61] By January 2012, it was gaining subscribers at a rate faster than both Sirius XM and Netflix.[62]

In a post-merger world, it seems very likely that Spotify would have never launched in the U.S., unless in a transmogrified 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.[63] 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 clauses vis-à-vis other labels; and (6) non-disclosure provisions.[64]

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 the innovation incentives for both new platform providers and the remaining major music labels in the United States.

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[60] Alex Pham, *Spotify Buttons Up Deals with Warner Music, Launches Service in the U.S.*, Los Angeles Times, (July 13, 2011), http://latimesblogs.latimes.com/entertainmentnewsbuzz/2011/07/spotify-buttons-up-deals-with-warner-launchesmusic-service-in-the-us-.html

[61] 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/spotifys-u-s-score-so-far-1-4-million-users-175000-paying-customers/

[62] 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

[63] Brenna Ehrlich, *Spotify to Cut Back on Free Music*, Mashable, April 14, 2011, http://mashable.com/2011/04/14/spotifylimited/.

[64] Michael Robertson, *Why Spotify Can Never Be Profitable: The Secret Demands of Record Labels*, GigaOM (Dec. 11, 2011), *available at* http://gigaom.com/2011/12/11/why-spotify-can-never-be-profitable-the-secret-demands-of-record-labels/.

The concern is not purely theoretical. Last year, Universal was involved in a French court case after seeking to block Deezer, a French streaming site, from using its catalogue after Deezer refused to follow the label's requirement of limiting its free offer to only five consecutive songs. The Paris high court ruled that this was in and of itself an abuse of a dominant position. Deezer had previous contracts with Universal, and the court based its decision on Universal's previous commitments in establishing the abuse. In other cases, potential entrants into the digital services market simply may not be able to secure an agreement with the label from the outset if the terms are too stringent. Also, new digital services may be blocked before the public even learns of their existence. The court stated that "[i]t cannot be contested that Universal's catalogue is . . . an essential and thus indispensable element for the size and coverage of the platform."[65]

E. The Monopsony Effect on Artists

Universal's acquisition of EMI's recorded music division may also adversely affect artists. The elimination of a major record company substantially reduces the options for artists wishing to sign with a major, where treatment from label to label varies. If, post merger, major labels limit the number of successful new digital services entrants, this would be detrimental to artists as well. Public Knowledge, a public interest advocacy group, has explained the benefits artists enjoy in a competitive environment:

> 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. 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, digital music services increase musicians' ability to craft artistically and financially successful career models. And empowering musicians benefits audiences, who enjoy new ways to access, experience, and interact with music.[66]

Apart from making music and getting it to consumers, artists must still strive to gain recognition, and that is why most wish to be signed by major labels. Major labels serve artists in

[65] Helienne Lindvall, *Universal's takeover of EMI poses threat to musical diversity,* The Guardian (March 9, 2012), http://www.guardian.co.uk/media/2012/mar/09/universal-takeover-emi-threaten-market.
[66] *See* Letter to FTC concerning UMG's proposed acquisition of EMI (March 07, 2012), Public Knowledge website, http://www.publicknowledge.org/letter-ftc-concerning-umgs-proposed-acquisition-em.

all levels of the market, from providing them with cash advances to manufacturing and distributing recordings, marketing their work, negotiating with digital distributors, retailers and the media, and more. The label company may even be involved with the artist's concert ticketing. Universal provides ticketing services in partnership with Live Nation.

Though major labels have recently started contracting with third party functionaries to do most of the work (so that the majors may focus primarily on sales), the majors still negotiate contract terms and assert bargaining pressure. Moreover, majors now sign so-called "360 deals," or multiple rights deals, which give them broader rights over artists. The deals include not only record sales, but also tours, promotions, merchandising and other income streams. The ability to sign 360 deals gives the major labels a significant advantage over independent labels, which are usually single-product sellers that cannot match the majors' scale, because they cannot offer the same range of services. Access to the market may be another impediment to independent labels; even very successful artists from independent labels eventually may need to sign with a major to have full media access. This was true of the artist Adele, who signed with Columbia from Sony in the United States. For all of these reasons, the proposed transaction threatens to severely disadvantage qualifying artists in bargaining with major labels for the provision of recorded music services.

F. Opposition to the Proposed Transaction and Past Behavior in the Industry

The Horizontal Merger Guidelines explain that the Agencies may consider evidence from customers, other industry participants and observers. Although the agencies "do not routinely rely on the overall views of rival firms regarding the competitive effects of the merger,"[67] rivals' overall views may be instructive "in cases where the Agencies are concerned that the merged entity may engage in exclusionary conduct."[68]

Warner's opposition to the proposed transaction is worth noting because Warner stands to benefit from price increases initiated by the merged firm. That Warner has publicly opposed the transaction seems probative of the transaction's potential exclusionary effects. Edgar Bronfman, on his final day as Chairman of the Warner Music Group (he will continue to serve on the Board of Directors), said that "allowing Universal to take ownership of the EMI record companies

[67]*See supra*, note 15 at § 2.2.3.
[68] *Id*.

would create what I call a super-major that would control not only the future of the recorded music [industry] but the future of all digital media."[69] He further explained that "[g]iven its size, the deal would not only impact the digital marketplace, it would drive down the economics of artists deals and impact cultural diversity."[70]

The views of the independent labels, which have vigorously opposed the transaction, are relevant for similar reasons. Impala, a trade association that represents independent music companies in Europe, has expressed concern that the transaction would create further barriers to expansion, particularly for independents in relation to retail access (both offline and online), marketing, media, distribution and the terms of licensing deals with online services. Rich Bengloff, the president of the American Association of Independent Music (A2IM), has also noted that "[t]he increased concentration of copyright ownership, historically, has always hurt the independent label community in terms of achieving economic parity and market access. We join our European Impala Independent music label colleagues in their concern over this acquisition and await more detail".[71]

Artists have expressed similar views. The Future of Music Coalition, a national non-profit organization that works to ensure that musicians have a voice in the issues that affect their livelihood, has expressed concern that "a more powerful UMG could affect the playing field for creators online."[72] The coalition has also expressed "fear that putting too much power in the hands of massive players would marginalize competition and artistic expression" and "not only would diversity in musical culture be diminished and distribution hampered, but musicians and songwriters may also end up not receiving monies owed."[73]

Past behavior in an industry also offers insight into how a merger will likely affect future conduct in a market, especially if it reveals a propensity for coordinated activities that may cross the line of legality. The major record labels in the past have engaged in coordinated

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[69] *See Warner will fight Universal's EMI takeover, says outgoing Chairman.* (February 1, 2012), http://www.thecmuwebsite.com/article/warner-will-fight-universals-emi-takeover-says-outgoing-chairman/.

[70] *See* Ed Christman. *Analysis: Edgar Bronfman's Big Statements About Universal/EMI Deal Are Business As Usual -- But Much More Public,* (February 02, 2012), http://www.billboard.biz/bbbiz/industry/record-labels/analysis-edgar-bronfman-s-big-statements-1006079952.story.

[71] *Id*.

[72] *See* Casey Rae-Hunter. *More mergers, more problems,* Technology and the Future of Music Blog (February 20, 2012), https://blogs.commons.georgetown.edu/cctp-636-spring2012/2012/02/20/more-mergers-more-problems/.

[73] Letter to the Federal Trade Commission, Future of Music Coalition, from Casey Rae-Hunter, http://futureofmusic.org/sites/default/files/FMC%20Letter%20to%20FTC_2_15.pdf

anticompetitive practices that negatively impacted competition and harmed consumers. In the 1990s, a price-fixing scheme among record companies sought to keep album prices high despite cost savings resulting from the introduction of compact disc (CD) technology. The FTC and the parties arrived at a consent decree in 2000. Another example involved the elimination of singles sales, even though singles were well-suited for CDs. (The advent of digital distribution has revived the dissemination of singles.)[74]

IV. Efficiencies and Other Justifications

A. Piracy

The merging parties have put forth several factors that would arguably counteract or outweigh the transaction's likely anticompetitve effects. Among other things, they have argued that rampant illegal music piracy and powerful buyers would prevent the exercise of market power in the recorded music services market.

Music piracy is a serious and lasting problem for the industry, and it has contributed to a significant decline in the industry's revenues.[75] However, the risks associated with obtaining music illegally -- moral concern, exposure to possible criminal liability, inferior product quality and potential exposure to computer viruses, among other things -- make piracy an unattractive option for a great many consumers. Indeed, the practice is in decline.[76] It seems especially questionable to suppose that consumers who today buy music legitimately would turn to illegal alternatives in the future in response to a small increase in price. As piracy is actively fought by regulators, it likely will be substantially reduced or eliminated completely. The proposed transaction must be viewed as permanent, and thus piracy is no defense.

B. Buyer Power

Likewise, the countervailing pressure of powerful buyers like iTunes, Wal-Mart, Best Buy and Target, cannot be trusted to preserve competition in the recorded music industry.

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[74] *See* Mark Cooper & 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), http://www.publicknowledge.org/case-against-umg-emi.

[75] Stephen E. Siwek, *The True Cost of Sound Recordings Piracy to the U.S. Economy,* The Institute for Policy Innovation, http://www.ipi.org/ipi_issues/detail/the-true-cost-of-sound-recording-piracy-to-the-us-economy.

[76] *See* Sean F, *Music Piracy Falls in 2011, But Revenue Also Drops, As Digital Distribution Grows* (Jan. 2012), http://www.digital-digest.com/news-63258-Music-Piracy-Falls-in-2011-But-Revenue-Also-Drops-As-Digital-Distribution-Grows.html.

Although iTunes reportedly has between 70% and 85% of the market for downloads,[77] and Wal-Mart, Best Buy and Target have an estimated 30-50% of the physical market, these companies will not constrain the music labels because they depend on the labels for access to a robust music catalogue to maintain their market positions.

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 any of the above companies will enter the recorded music business. There is also no reason to suspect that those companies will undermine coordination, because they are not choosing one supplier over another but rather must have deals in place with all of the suppliers, as discussed above. If anything, having fewer major labels with which to negotiate would only undermine any leverage they might otherwise enjoy.

C. Efficiency Claims Are Unsubstantiated

From what we can see in the public record, efficiencies defenses by the merging parties are likely to fail to satisfy the requirements of the Horizontal Merger Guidelines. Because the transaction is presumptively anticompetitive, the parties would have to demonstrate that efficiencies are cognizable, substantiated and verifiable by reasonable means, merger specific and of a character and magnitude sufficient to reverse the merger's potential harm to consumers in the relevant market.[78]

Universal has stated that it anticipates synergies after combining with EMI, which would in part reduce overhead.[79] The types of synergies the parties have referred to, however, are only cost synergies, and Universal confirmed that it is already undertaking a cost savings program, which is quite substantial. Therefore, the post-merger cost synergies would be merely incremental.[80] The Agencies have already stated that they will "credit only those efficiencies

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[77] *The NPD Group: Amazon Ties Walmart as Second-Ranked U.S. Music Retailer, Behind Industry-Leader iTunes,* The NPD Group, https://www.npd.com/wps/portal/npd/us/news/pressreleases/pr_100526/!ut/p/c5/*04_SB8K8xLLM9MSSzPy8xBz9CP0os3g3b1NTS98QY0P3EHNzA0PAE9XT0Mfo9AQU_1I_ShznPLGJvoF2YGKAOiAlUE!/.* However, competition in online music markets is reportedly growing, as strong retailers like Amazon and Google are launching their own online music services to compete with iTunes. *See also Google Music vs Amazon MP3 vs iTunes: Which Online Music Store is the Best for You?,* Lifehacker (November 18, 2011), http://lifehacker.com/5860817/google-music-vs-amazon-mp3-vs-itunes-which-online-music-store-is-the-best-for-you. Increased competition downstream undermines the power buyer argument.

[78] *See supra* note 15 at § 10.

[79] *Vivendi SA and Universal Music Group to Purchase EMI Music Conference Call* - Final FD (Fair Disclosure) Wire, November 11, 2011, at 4.

[80] *Id*.

likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects," i.e. merger-specific efficiencies.[81] The bulk of Universal's claimed synergies likely are not merger-specific.

The parties have also argued that, absent the transaction, EMI's future would be very uncertain, as the company has not been effective in signing new artists in recent years.[82] Universal's distribution network is also said to give EMI artists greater international reach, while EMI's labels would help Universal put out more music than ever before, including in the country music genre through EMI's Nashville label.[83] None of these claimed efficiencies, however, are likely to be considered beneficial to consumers, merger-specific and verifiable. There are no indications of price reductions or product improvements.

Finally, even if Universal could substantiate its efficiency claims, the procompetitive benefits of the transaction would be hard-pressed to outweigh its likely anticompetitive harm. As the Agencies explain, "efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great."[84] As outlined above, that is simply not the case here.

V. Enforcers Should Be Skeptical of Remedies Short of Injunctive Relief

For the reasons discussed above, a regulatory solution may not adequately solve the competitive problems posed by the proposed transaction, and we encourage the FTC to consider enjoining it. Although significant divestitures could contribute to reestablishing competition, they would do little to address the harm posed by a reduction from 4 to 3 majors, including the negative effects on innovation incentives in downstream distribution markets.

Even if Universal could divest enough assets to reduce its market share considerably, its power would still increase substantially because of the absence of competitors that would be able to assist in counteracting its dominant position. Setting aside market shares, the industry would be left with three major labels and many distant, dispersed, smaller independent labels.

[81] *Id*., at 9.
[82] *See* Steve Knopper, *How the Universal-EMI deal will change the music industry,* Rollingstone.com (November 23, 2011), *available at* http://www.rollingstone.com/music/news/how-the-universal-emi-deal-will-change-the-music-industry-20111123#ixzz1ojTVdiR6.
[83] *Id*.
[84] *Id*., at 9.

Universal's repertoire would remain a must-have for new digital services entrants, and its leverage over new and existing entrants would grow and persist, as would its leverage over artists. An acceptable divestitures package would need to give another label enough to compete with the three remaining players, essentially recreating a fourth major. However, such a package likely would undermine the purpose of the deal from Universal's perspective.

Nonetheless, Universal reportedly has been negotiating a divestitures package with the EC. Although its initial offering, consisting mainly of older back-catalogue artists, did not satisfy the EC, it recently presented a more generous package containing the valuable Parlophone label (but excluding The Beatles). While it remains to be seen whether European enforcers can arrive at an acceptable package, that outcome should have little if any bearing on what would be acceptable for the U.S. market, which is a separate relevant market.

Another concern is whether the remedy would be sustainable. For example, would artists opt to leave the third party acquirer at the end of their contracts? Record labels develop relationships with artists, and artists may choose to return to the label that has supported the development of their careers. Moreover, artists may be especially resistant to moving from a major to a third-party minor label. Evaluating artists' ability to refuse to transfer, the duration of artists' contracts, and other practical problems associated with executing a divestitures remedy is an important part of assessing the adequacy of a divestitures remedy generally.

VI. Conclusion

Based on an analysis of publicly available information, we believe Universal's acquisition of EMI's recorded music division may substantially harm competition in the U.S. markets for physical and digital recorded music services. It appears unlikely that an adequate divestitures package tailored to the U.S. market would satisfy the merging parties and at the same time address structural competitive problems in the industry and the threat of harm to downstream innovation incentives. We also believe that piracy and buyer power are unlikely to counteract the transaction's likely competitive effects. Instead, the elimination of a key competitor – and a maverick – threatens to destabilize the current balance that exists between majors, a balance that still fosters the introduction of innovative new digital services. Claimed efficiencies do not appear to be merger specific and in any event do not yield procompetitive benefits likely to outweigh the risk of anticompetitive harm, which includes unilateral,

coordinated and exclusionary effects, diminished innovation, and diminished artist and end-user choice. For all of these reasons, we encourage the FTC to consider enjoining the proposed transaction in its entirety.

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