

ANTITRUST

The authors warn that arguments in favor of a proposed merger of Universal Music Group and EMI are “out of tune.”

Antitrust Regulators Face the Music (Industry)



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The music industry will change—if not by choice, then by necessity. Consumers, intoxicated by the whiff of “free” music, clamor for the platonic model of availability and affordability. Music copyright owners, generally record labels and publishers, steadfastly guard their intellectual property while attempting to maximize licensing revenues. Digital distribution platforms attempt to bridge the two by licensing vast music catalogs and feeding consumers’ insatiable hunger for on-demand, inexpensive music.

Digital distribution is at the heart of the debate over the proposed acquisition of EMI’s recorded-music business by Universal Music Group, which would create the largest record label in the industry. It was the prime topic at the June 21, Senate subcommittee hearing ominously titled “The Universal Music Group-EMI Merger and the Future of Online Music” (84 PTCJ 350, 6/29/12).

Opponents of the deal claim that consolidation in the recorded music business—from the “Big Four” record labels to the “Big Three”—will harm consumers. According to Public Knowledge and the Consumer Federation of America, the acquisition would give Universal-EMI approximately 40 percent of the recorded music sales in the United States, and would give

¹ The opinions expressed are those of the authors and do not necessarily reflect the opinions of the firm, its clients, or other entities. This article is intended for general information purposes and is not intended to be, and should not be taken as, legal advice.

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it—by virtue of recorded music rights and/or at least partial music publishing rights—more than half of the Billboard Hot 100 for 2011.²

With such clout, opponents argue, Universal-EMI could dictate the terms on which digital distribution platforms are allowed to access Universal-EMI’s “must have” catalog. A corollary, in the words of Edgar Bronfman Jr., director of Warner Music Group, is that “one firm, Universal/EMI, would be in a position to pick winners and losers among digital music services.”³

Note to those who think the only *true* medium is vinyl: digital distribution is not a sideshow; in many ways it is the main event. In 2011, digital music sales exceeded physical sales for the first time in history, accounting for 50.3 percent of all music purchases.⁴

As best we can tell, the merging parties offered three main arguments in support of the merger.

Argument 1: The Old Industry Landscape Is Gone

First, Universal and EMI argue that tectonic technological advances have taken the ground out from beneath the labels’ feet. Artists can now create music and distribute it through the internet with relatively little cost.

In the words of Universal’s Lucian Grainge, “technology and the internet have enabled anyone to create music, market music, and distribute music.” Proponents of the merger claim that labels face stiff competition from everywhere, and that they may even be rendered somewhat obsolete.

However necessary a label’s services for the creation, marketing, and distribution of music may or may not continue to be, these are but a few of the valuable—and sometimes invaluable—services that record labels provide. The strength of record labels’ large catalogs enables them to obtain better licensing terms than indi-

² Testimony of Gigi B. Sohn, president, Public Knowledge, on behalf of Public Knowledge and Consumer Federation of America, before the Senate Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights, for hearing on: “The Universal Music Group/EMI Merger and the Future of Online Music” (June 21, 2012) at <http://www.judiciary.senate.gov/pdf/12-6-21SohnTestimony.pdf>

³ Written testimony of Edgar Bronfman Jr., director, Warner Music Group, hearing before the Senate Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights on “The Universal Music Group/EMI Merger and the Future of Online Music” (June 21, 2012) (hereinafter “Bronfman Testimony”) at <http://www.judiciary.senate.gov/pdf/12-6-21BronfmanTestimony.pdf>

⁴ Nielsen Co and Billboard’s 2011 Music Industry Report, Jan. 5, 2012, at <http://www.businesswire.com/news/home/20120105005547/en/Nielsen-Company-Billboard%E2%80%99s-2011-Music-Industry-Report>

vidual artists could obtain on their own. Labels also effectively and efficiently protect and litigate against copyright infringements because labels have the resources to do so and can spread the costs of copyright enforcement over many, many artists and copyrights.

Perhaps this is why technology has not significantly impacted the market shares of the major record labels. What the proponents of the merger view as a tectonic shift has been occurring for the last few years; however, the market shares of the Big Four have remained almost perfectly stable during that time.⁵

Stability in a concentrated industry may be an indicator of the likely competitive effects of a merger. The federal antitrust agencies' Horizontal Merger Guidelines state, "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."⁶

With respect to this deal, the American Antitrust Institute argues that "the stability of recorded music market shares over time explodes the notion that independents are faring better in a digital world."⁷

Just because a garage band from Anchorage, Alaska, has a friend with ProTools, a cable modem, and a MySpace page, doesn't mean the band won't seek a record-label deal to maximize the value of its creations. Record labels continue to be an important and essential element in artists' success, as Warner Music Group's Edgar Bronfman Jr. argued before the Senate subcommittee.⁸

Argument 2: Powerful Buyers Will Prevent Universal-EMI's Exercise of Market Power

Second, proponents of the merger argue that powerful buyers, i.e., Apple Inc., will constrain the merged entity's ability to raise prices. Apple has revolutionized digital music downloads and continues to be a market leader. Some reports peg Apple's market share of digital music downloads at around 70 percent.⁹

But even Apple needs what the labels have, and the more the labels have, the more Apple needs them. Consumers want digital music platforms to deliver all or most of their music needs.

⁵ See Written statement of the American Antitrust Institute before the Senate Judiciary 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) (hereinafter "AAI Statement") at <http://www.antitrustinstitute.org/~antitrust/sites/default/files/aai-%20Universal-EMI%20testimony.6-19-12.pdf>

⁶ U.S. Department of Justice Antitrust Division/Federal Trade Commission Horizontal Merger Guidelines § 5.3 (Aug. 19, 2010) (hereinafter "Guidelines") at <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf>

⁷ AAI statement at http://latimesblogs.latimes.com/music_blog/2011/04/price-war-amazon-launches-69-cent-mp3-store-for-top-selling-tunes.html

⁸ Bronfman testimony ("I know we all love the mystique surrounding the notion of 'garagebands', 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.")

⁹ AAI statement (citing Alex Pham, "Price War! Amazon Launches 69-cent MP3 Store for Top-Selling Tunes," *Los Angeles Times*, April 28, 2011, at http://latimesblogs.latimes.com/music_blog/2011/04/price-war-amazon-launches-69-cent-mp3-store-for-top-selling-tunes.html).

As Emily White writes in her controversial article, which has since gone viral: "What I want is one massive Spotify-like catalog of music that will sync to my phone and various home entertainment devices. With this new universal database, everyone would have convenient access to everything that has ever been recorded . . ."¹⁰

Consumers want a broad selection, so digital distribution services must provide a broad selection. In the words of Martin Mills, Founder and CEO of Beggars Group, "no company, no matter how big, can run a music service without Universal because its repertoire cannot be obtained elsewhere."¹¹

With such a large share of the most popular recorded music, Universal-EMI would very likely be able to command favorable licensing terms (e.g., higher prices, an equity stake, reporting obligations)¹² from digital music platforms, even iTunes. Apple's recent 10-K cautions that it "contracts with third parties to offer their digital content through the iTunes Store" and that "[t]he licensing arrangements with these third parties are short-term and do not guarantee the continuation or renewal of these arrangements on reasonable terms, if at all."¹³

The relevant inquiry under Section 7 of the Clayton Act, which provides the standard for mergers and acquisitions, is not only whether the deal would enable the combined entity to cut off access to its products, services, or content, but whether the deal is likely to "substantially . . . lessen competition," such as by raising prices.

It's also not clear to what extent Apple would challenge more burdensome licensing terms, such as higher licensing rates. Apple is in a much better position to afford higher licensing rates than are iTunes's competitors like Spotify.

Apple also has a greater ability to pass on higher costs to its consumers. So higher licensing rates might actually give Apple a comparative competitive advantage, especially if Apple's rates don't increase as much as its competitors' because the labels need the revenue driven by iTunes.

Argument 3: 'It's the Music That Matters, Not the Source.'

The third principal argument offered by the proponents of the merger is that, in the words of EMI Group's chief executive, Roger Faxon, "it's the music that matters, not the source of that music."¹⁴ The proponents argue that the power is in the consumer's hands because the consumer ultimately decides what music she likes and has a multitude of sources to find it; accordingly, it

¹⁰ Emily White, "I Never Owned Any Music to Begin With," *NPR Music*, June 16, 2012, at <http://www.npr.org/blogs/allsongs/2012/06/16/154863819/i-never-owned-any-music-to-begin-with>.

¹¹ Statement of Martin Mills, founder and CEO, Beggars Group, to U.S. Senate, Antitrust, Competition Policy, and Consumer Rights Subcommittee, In re: Universal Music Group/EMI Merger and the Future of Online Music (June 21, 2012).

¹² See AAI statement at <http://www.judiciary.senate.gov/pdf/12-6-21MillsTestimony.pdf>

¹³ Apple Inc., Form 10-K for fiscal year ended Sept. 24, 2011.

¹⁴ Written submission before the Senate Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights, Roger Faxon, Chief Executive, EMI Group (June 21, 2012).

is in the labels' interests to license their catalogs in as many digital spaces as possible.

This argument ignores consumer preferences and the commercial reality of digital music distribution. Consumers don't want to hunt-and-peck for music. They want all their music easily accessible anytime, from anywhere, and on any number of devices.

Digital distribution platforms with massive music catalogs satisfy that demand. And the commercial reality of digital distribution is that a digital platform would have no choice but to license Universal's monster catalog should the deal go through. Indeed, Universal acknowledges that it "already ha[s] countless 'must have' songs—whether it is the Motown collection or Elton John or U2."¹⁵

¹⁵ Written submission of Universal Music Group before the Senate Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights, Lucian Grainge, CBE chairman and CEO (June 21, 2012) at <http://www.judiciary.senate.gov/pdf/12-6-21GraingeTestimony.pdf>

Conclusion

In sum, Universal and EMI's arguments for allowing the deal sound out-of-tune with commercial reality and with antitrust laws. The power of owning so much "must-have" music would enable a combined Universal-EMI entity to leverage its catalog to extract more favorable terms from digital platforms and, by extension, consumers, notwithstanding the existence of such large platforms as Apple's iTunes.

Not surprisingly, the European Commission has issued a formal, confidential Statement of Objections to Universal, and the FTC is also currently reviewing the deal. They have our sympathies.

Applying traditional antitrust analysis to an industry full of idiosyncrasies, such as the music industry, is undoubtedly challenging and raises many issues beyond those addressed here. But ensuring competition in this industry is certainly music to our ears.