TESTIMONY
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Hearing before the
Senate Committee on the 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
Washington, DC

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

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[1] http://pewinternet.org/Reports/2010/Paying-for-online-content.aspx.
[2] http://www.synovate.com/news/article/2010/02/synovate-survey-one-third-of-americans-would-give-anything-to-meet-their-music-idols-many-ok-with-sharing-personal-info-for-free-music-downloads.html.
[3] See http://blogs.forrester.com/mark_mulligan/11-01-26-why_and_how_digital_music_products_have_indeed_failed.

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.[4] 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

[4] See PricewaterhouseCoopers, *Global Entertainment and Media Outlook, 2012 – 2016*, pp 269-272.

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 <u>good</u> 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.

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[5] *See* Meghan Kelly, *Apple Hits $600B Market Cap, Still The World's Most Valuable Company* (*Reuters* April 10, 2012) available at http://www.reuters.com/article/2012/04/10/idUS83271455720120410.
[6] See https://www.npd.com/wps/portal/npd/us/news/pressreleases/pr_110928.

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

Company	Pre-Merger U.S. Revenue Share	Post-Merger U.S. Revenue Share
Universal	31.3%	41.7%
EMI	10.4%	
Sony	28.5%	28.5%
Warner	20.3%	20.3%
Other	9.4%	9.4%

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[7] 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?

[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.[8] 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;[9]
- 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;[10]
- Less than a month after launching in the U.S. in the summer of 2011, Spotify had more than 1.4 million users;[11]

[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* (*msnbc.com*, August 10, 2011) available at http://www.msnbc.msn.com/id/44090899/ns/business-us_business/t/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/.

[10] https://www.npd.com/wps/portal/npd/us/news/pressreleases/pr_120306.

- Sirius XM Radio has 21.9 million subscribers;[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;[13] and

- 43% of the U.S. Internet population listened to online radio in 2011.[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.[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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[11] http://allthingsd.com/20110808/spotifys-u-s-score-so-far-1-4-million-users-175000-paying-customers/.
[12] http://files.shareholder.com/downloads/SIRI/1796640914x0x559248/2AED8B19-6E00-43EA-B61E-A42B2C473CC2/Sirius_XM_AR.pdf.
[13] http://investor.pandora.com/phoenix.zhtml?c=227956&p=irol-sec.
[14] https://www.npd.com/wps/portal/npd/us/news/pressreleases/pr_120306.
[15] *See* Walter Isaacson, *Steve Jobs* (2011), Ch. 31.

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.[16] 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 obliterate 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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[16] *See, e.g.*, "*Music Service Beyond Oblivion Folds Before Launch*," (*The Guardian (UK),* January 4, 2012), available at http://www.guardian.co.uk/technology/2012/jan/04/music-service-beyond-oblivion-folds; "*Apple has Acquired Lala*" (*TechCrunch*, December 9, 2009), available at http://techcrunch.com/2009/12/04/apple-acquires-lala/.

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."[17]

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….."[18]

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.[19]

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[17] See Ethan Smith, "*Music-Merger Bid Plays Out" (The Wall Street Journal*, June 20, 2012), available at http://online.wsj.com/article/SB10001424052702303379204577476963753682088.html

[18] See Helienne Lindvall, "*Spotify Should Give Indies a Fair Deal on Royalties" (The Guardian*, February 1, 2011), available at: http://www.guardian.co.uk/media/pda/2011/feb/01/spotify-royalties-independents

[19] See "Tribunal de Grande Instance de Paris Ordonnance de Référé; September 5, 2011: Universal Music France / Blogmusik," (*Legalis*, September 15, 2011); also "*Musique en ligne: Universal Music deboute 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.[20] 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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refere" (*Le Monde*, September 5, 2011); also "*TTLF Technology Law and Policy News*," (*Stanford Vienna Transatlantic Technology Law Forum*, November 4, 2011)

[20] See Diane Bartz, "*Senate Panel to Consider Universal Deal to Buy EMI Catalog*" (*Reuters*, June 8, 2012), available at: http://www.reuters.com/article/2012/06/08/us-emi-umg-congress-idUSBRE8571DP20120608

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."[21] 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

[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."[22] 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.[23]

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/newsbysector/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.