Testimony of Gigi B. Sohn,
President, Public Knowledge
On behalf of
Public Knowledge and Consumer Federation of America

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

Hearing On:
"The Universal Music Group/EMI Merger and the Future of Online Music"

Washington, DC
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Chairman Kohl, Ranking Member Lee, and Members of the Subcommittee, thank you for this opportunity to discuss the significant consumer harms the Universal Music Group ("UMG") and EMI Music merger would cause if allowed. My name is Gigi Sohn and I am the President of Public Knowledge, a nonprofit public interest organization that addresses the impact of copyright on competition and innovation in digital technology.[1]

Introduction

The proposed merger of the major record labels UMG and EMI Music comes at an important time for music fans and the music industry. Innovative companies using digital technologies have found new ways to give musicians and consumers more choices for how and where to create and experience recorded music. Digital music distribution in particular has benefitted consumers by enabling them to access music more conveniently and more directly from the artists. Gone are the days when music fans could only listen to the latest album if they traveled to a physical record store, bought the album, and brought it back home to play on a home stereo system. Now, digital technology allows consumers to buy music at the click of a button and listen to that music on their stereo, computer, mp3 player, smartphone, or any number of personal devices. Digital platforms also dramatically decrease distribution costs, which in a competitive market results in cost savings for the consumer. However, nothing is immune to market power and a merger of this magnitude can easily stifle the consumer benefits of digital distribution.

These technologies hold great promise for recording artists and consumers, but nascent entrants in the market dependent on licenses from incumbent labels are vulnerable to anticompetitive behavior by the major labels. For example, the company Deezer, digital music streaming service similar to Spotify, has enjoyed success in 81 countries around the world, but does not offer its service in the U.S. Deezer has also

[1] I would like to thank my Public Knowledge colleagues Jodie Griffin, Ernesto Falcon, Martyn Griffen, and Clarissa Ramon for assisting me with the research and drafting of this testimony. I would like to give special thanks to Mark Cooper, Director of Research, Consumer Federation of America for his assistance.

partnered with numerous other companies, including social networks like Facebook and Twitter, mobile telephone services like T-Mobile, stereo system manufacturers like Sonos and Logitech, and car manufacturers like Nissan and Parrot. These partnerships create new services that increase music fans' opportunities to enjoy music conveniently and at a reasonable price. But when asked why none of these innovative new services have reached the U.S. market, Deezer representatives point to the cost of licensing the music from the major labels.

The major labels can thwart or seize control of innovation with anticompetitive behavior against new market entrants that cannot operate without sound recording licenses from the major labels. The merger between UMG and EMI would create a new super-major label that controls 41% of the recorded music market, and could use that market share to stifle the development of new digital platforms while raising prices to the detriment of both musicians and their fans. To prevent this result, antitrust authorities must block this merger to protect the future of innovation, competition, and pricing in the music business.

Digital technology's ability to let artists reach fans directly has been a powerful, consumer-friendly, competition-friendly force in the music industry. However, it is not immune from the abuse of market power by entrenched physical space incumbents. Incumbent major record labels have the incentive to stifle new digital distribution platforms because those platforms begin to level the playing field among major labels, independent labels, and unsigned artists. Digital platforms are more likely to license unknown or niche music because, unlike their physical space predecessors, they are not constrained by time limits (like radio) or space limits (like physical stores). As a result, the major record labels lose one of their main selling points to musicians—namely, that they have the connections and influence that a musician absolutely needs to get his or her music out in the marketplace. Thus, the dominant incumbent labels are particularly incentivized to stifle digital platforms that will decrease their influence as compared to smaller competitors or unsigned acts.

This merger bears striking similarity to the recent failed merger attempt by wireless carriers AT&T and T-Mobile. Both proposed mergers threatened to drop the number of major competitors from 4 to 3 and radically change their respective industries. Both mergers would have strengthened the power of an already-dominant firm to stifle its competition in the marketplace. And in both mergers, the acquisition target (T-Mobile and EMI, respectively) was the fourth-largest firm in the marketplace with a proven track record of pressuring the larger firms as a maverick competitor. In the AT&T-T-Mobile merger, the Department of Justice recognized that the deal would impose serious harms on consumers and rightfully filed suit. Just as the government protected consumers by fighting the AT&T-T-Mobile merger, the antitrust authorities should prevent Universal from buying out one of its most innovative competitors.

EMI Music Has Historically Been Willing to Take Risks and Innovate

As the fourth largest label in the marketplace, EMI must continuously explore opportunities to grow market share by attracting customers and recruiting new talent. Unlike its larger competitors, EMI cannot be complacent and focus on merely preserving its market share but rather must be a scrappy contender willing to try the unorthodox. With regard to digital music services, EMI Music has consistently been the first major label willing to take risks and innovate. As a result, consumers have reaped the benefit of music that can play on more devices and services than ever before at price points they demand and artists have benefited from having a label more willing to meet their needs in exchange for their talent. For example:

- In 2000, EMI became the first major label to license its catalog to the online subscription streaming service Streamwaves, and in 2001 EMI became the first label to license to a digital music service, PressPlay without demanding an equity interest in the service. UMG did not sign a deal until a full two years later, which in the fast moving pace of the Internet economy is practically a lifetime. In fact, by the time UMG signed on with Streamwaves in June 2002, EMI had already entered into nine different digital download deals with digital distribution companies like MusicNet, Ecast, and Liquid Audio.

- In 2007, EMI became the first of the major labels to offer digital downloads through the iTunes music store without digital locks on the files. This made the files much easier to use and listen to on a variety of devices and was very popular with consumers. It is worth recalling that Apple's CEO Steve Jobs, arguably one of the most innovative individuals in modern times, called for the removal of DRM in an open letter to the recording industry and accurately predicted an increase in investment and innovation in digital music. It was not until the following year that the remaining major labels followed EMI's leadership.

- In 2009, EMI was the first major label, with the band Depeche Mode, to offer an iTunes Pass, a digital music product similar to a deluxe CD package with additional limited edition materials included. Later, EMI was also one of the first labels to sign with Project Playlist, Spotify, and Apple's iTunes Match.

- EMI has launched OpenEMI, a partnership with The Echo Nest, which allows application developers to access parts of the EMI Music catalog to develop new ways to distribute music. In addition to providing startups and developers API access to content, EMI acts as a liaison between developers and recording artists, holds weekly calls with developers, and requires no advance royalties or flat licensing fees application makers. Developers and EMI split profits 40/60, with EMI distributing its share to the appropriate rights holders. Notably, EMI has been the only major label to launch this type of open API initiative and it is questionable if this project would even continue under UMG ownership given its own history of resisting innovation.

New Digital Distribution Services Benefit Consumers

EMI's leadership in the industry has helped promote the growth of digital music services, which has benefited both musicians and audiences by offering new opportunities for artists to create, promote, distribute, and monetize their works. Digital technology lets consumers choose when and where they want to enjoy music, and enables consumers to purchase music at the click of a button. Innovative new digital services also decrease the cost of manufacturing and distribution, which in a competitive marketplace would be passed on to consumers as cost savings.

It is no surprise that digital distribution services are increasingly popular with consumers. They give users more flexibility in choosing when and where they will listen to music, and often add new features and functionalities past what a typical AM/FM radio or stereo could do. Consumer demand for these new services has grown significantly as the average amount of time that an active user spent using music apps alone increased 72% between October 2011 and May 2012.[2] In one recent Nielsen survey, 72% of consumers choose either online PC purchases or mobile purchase as their preferred way to buy music. Those surveyed indicated those purchases were easier and more convenient than in-store purchases.[3]

When record labels and other copyright owners are willing to explore new digital distribution technologies, new services that benefit both consumers and artists enter the marketplace. Several new digital music services demonstrate the creative new offerings that can arise if record labels feel competitive pressure from rival labels to find new avenues to reach consumers:

- **Deezer**. Deezer is a web-based music streaming service, similar to Spotify. This past May, Deezer launched Open Deezer, offering open access to its API for developers to create new music streaming services. Even in the short time since the API has been launched, Deezer has launched partnerships with social networks (for example, Facebook, Twitter, and last.fm), mobile telephone services (Orange, Belgacom, and T-Mobile), high-end hi-fi systems manufacturers (Sonos and Logitech), and automobile industry manufacturers (Nissan and Parrot). Deezer encourages new apps by rewarding developers whose apps lead to new Deezer subscribers, and by hosting hackathons. Unfortunately, neither Deezer's core service nor any of its new applications can be used by U.S. consumers because Deezer does not have the necessary licensing for the U.S. When Deezer's COO and CFO Simon Baldeyrou was asked last week about why Deezer has not brought its services to the U.S., one of his first responses was that "[t]he price to enter the market is very high." Deezer has previously noted that "being able to negotiate correct deals with the labels" is among the top factors

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[2] Eliot Van Buskirk, *People Are Spending Way More Time on Music Apps*, EVOLVER.FM (June 8, 2012), http://evolver.fm/2012/06/08/report-people-are-spending-way-more-time-on-music-apps/.

[3] *Shopper Sentiment: How Consumers Feel About Shopping In-Store, Online, and via Mobile*, NIELSEN WIRE (June 6, 2012), http://blog.nielsen.com/nielsenwire/consumer/shopper-sentiment-how-consumers-feel-about-shopping-in-store-online-and-via-mobile/.

slowing Deezer's entry into the US market despite having enjoyed success in 81 countries to date.

- **Spotify**. Last November, music streaming service Spotify announced that it would be granting developers access to its music library by way of an app framework. This initiative has resulted in several exciting new apps, like Songkick, which suggests upcoming concerts to users based on their music catalog, Soundrop, a social radio station app, or Pitchfork's music app, which lets users listen to albums and songs while they read Pitchfork reviews of the music. Spotify has also begun launching branded apps with non-music partners like McDonalds and Intel, opening a new potential revenue model for artists in digital distribution.

Currently, the United States is either a late adopter or non-adopter of these new digital music services. If the merger between UMG and EMI were to proceed, it would only exacerbate that decline and more of these businesses will start overseas rather than here at home. Any digital music service that depends upon a music library of substantial breadth and depth, such as Spotify or the iTunes music store, will fail if it cannot offer a critical mass of popular music to consumers. The success of these outlets will affect other distribution platform developers as well as consumers looking for easy, reasonable access to music.

New Digital Distribution Services Benefit Artists

In addition to offering innovative new services for consumers, digital distribution services give artists more control over their own careers. These new services make it easier for musicians to bring their works to market without relying on a record label to handle marketing, promotion, and distribution. For example, while it was traditionally near-impossible for musicians to convince a large record store to carry their albums without being signed to a record label, unsigned artists can now use the iTunes distribution service to sell copies of their recordings to the public. Musicians often distribute their music through an aggregator like CD Baby or Pure Play Music, which help artists with physical distribution, digital distribution, and music licensing. Artists can use these powerful distribution technologies to reach diverse audiences while maintaining control over the timing, length, and musical content of their works.

New digital distribution services eliminate artists' need for a middleman to reach their fans. Advances in recording technology allow a musician to make high quality recordings without a recording studio. New online social media platforms enable artists to promote their work and develop relationships with fans without a record label's marketing department. Finally, online distribution tools and platforms allow artists to reach users via their own websites or on new platforms and distribute their music to fans directly. An artist may still decide that she would prefer to "hire" a record label to perform those services in exchange for copyright ownership and a large chunk of future royalties, but digital disintermediation gives the artist a meaningful choice between a record label and an independent career.

Digital technology also increases efficiency in distribution and benefits consumers by increasing their access to music products and the ease with which they can enter into transactions with artists. For physical products, a large portion of the cost of a good is the costs of manufacturing the good. Digital technologies dramatically lower these costs—after all, an mp3 is much less costly to make, transmit, and store than a vinyl record, cassette tape, or even a CD. As a result, consumers will theoretically enjoy lower prices in procuring recorded music and more flexibility in how, when, and where they listen to it. However, the dominant physical firms—here, major record labels—have a strong incentive to thwart this trend to enjoy continued control and higher profits.

Digital technology opens an entire new world of options for musicians as they decide how they want to make and share their music. New development and distribution services empower musicians to choose how they will shape their careers and help musicians be more responsive to audience demand for their work. Musicians may still choose a more traditional, transaction-based outreach and distribution model, or they may choose to build deeper relationships with their fans or experiment with new distribution methods. Each strategy presents different advantages and challenges, and the right choice will depend upon the unique position of each individual artist. By giving musicians more options from which to choose, the advent of digital music distribution services increases musicians' ability to craft artistically and financially successful career models. Empowering musicians subsequently benefits audiences, who will enjoy new ways to discover, access, experience, and interact with music.

Digital distribution services do not just enable artists to pursue new business models, but also new business principles. Major labels traditionally pursue mass-market promotion strategies using established distribution methods. This strategy can be an effective way to be heard by a large audience, but in the process the artist may sacrifice building stronger relationships with her fans and also takes the risk that she will not receive as much attention from the label when she is only one of thousands of signed acts. If the artist builds a career without signing to a major label, she may choose to use a more relationship-based business model—building stronger connections with a (at least initially) smaller audience, and letting fans help write the narrative of the artist's career. Importantly, neither one of these options is inherently better than the other—the point is that new digital music services give artists a **choice**.

A Combined UMG/EMI Would Have the Power to Prevent or Control New Digital Music Services to the Detriment of Consumers

Digital music services often depend upon the cooperation or collaboration of the record labels that own the relevant sound recording copyrights or the publishers that control the musical compositions. As audience demand currently turns to a streaming, cloud-based model, new distribution services will have trouble launching without a major label willing to be the first to grant licenses, and ultimately may never succeed if a single major label can withhold 41% of the recorded music market even after other labels have started working with the service. Even in today's marketplace, a major label can wield sufficient power to demand that potential new digital music services pay the label hefty advances and a high percentage of future revenue, or give the record label an equity stake in the new company. A combined Universal/EMI entity would only be able to exert even more control over new music services.

The proposed merger would dramatically increase the UMG/EMI's control over sound recordings of popular music—both current and catalog albums—to which competing distribution models must have access to succeed. For example, a combined UMG/EMI would control six out of the top ten best-selling albums of all time.[4]

By virtue of its dominant market share of 41%, the post-merger UMG/EMI would be able to exert its market power over nascent digital distribution platforms and could either license its must-have catalog on onerous terms or thwart the success of the service by withholding its catalog altogether. The threat that this merger poses to new competition in the recorded music marketplace only magnifies concerns raised about the anticompetitive effects of the merger under traditional antitrust analysis.

Moving forward, a post-acquisition Universal would be in a position to further its dominance by withholding licenses for its recorded music and music publishing rights. After UMG acquires EMI's recorded music division, it would control 41% of all recorded music sales in the U.S.—more than twice the 20% share of Warner Music Group, the third-largest label in the market.[5] After the acquisition, the joint entity would control the recorded music rights and/or at least some portion of the music publishing rights to some of the most popular music in today's market, including 68 of the Billboard Hot 100 titles for calendar year 2011.[6] This sort of control would put Universal in a position to "make or break" any new service all by itself, allowing it to hamper innovation and/or demand exorbitant terms and conditions. As a result, consumers must either miss out on potential new services or pay excessive fees for those services.

Similarly, Sony/ATV Music Publishing's acquisition of EMI Music Publishing would give it a significant blocking position in music publishing worldwide.[7] If combined, the Sony/EMI publisher would control over 32% of music publishing revenues worldwide, making the combined entity 40% larger than its nearest publishing competitor, Universal, and more than twice the size of Warner's publishing operations.[8] Here in the U.S., it would hold at least some portion of the publishing rights to 64 of the

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[4] *The Nielsen Company & Billboard's 2011 Music Industry Report*, 7 (Jan. 5, 2012).

[5] Alice Enders & Ben Rumley, *EMI: The Game of Music Chairs Continues*, ENDERS ANALYSIS at 6 (Dec. 7, 2011). These numbers include sound recordings owned by independent labels or musicians but distributed through one of the major labels. To the extent that UMG's distribution contracts with smaller labels allow it to set (or refuse to set) prices and rates with digital distributors for those labels' recordings, those contracts increase UMG's leverage over digital distributors and should be considered here. In turn, UMG's increased control over digital distribution will allow it to demand a higher percentage of sales and licenses from the smaller labels in its general distribution agreements.

[6] *Billboard Hot 100*, http://www.billboard.com/charts/hot-100 (last visited Feb. 29, 2012).

[7] *Music & Copyright*, INFORMA TELECOMS & MEDIA, 3 (Mar. 23, 2011) (estimating a 19.7% music publishing market share for EMI and a 12.5% market share for Sony).

[8] *Id.*

Billboard Hot 100 titles for calendar year 2011, including titles for which the recording rights are currently held by its competitors.[9] Moreover, it would control the recorded music rights and/or at least some portion of the music publishing rights to 79 of the Billboard Hot 100 titles for calendar year 2011.[10]

If both the UMG/EMI record label merger and Sony/EMI publisher merger are approved, UMG and Sony's combined sound recording and composition catalogs would give them enormous leverage over a nascent digital music service. In essence, the two majors' whims would control the emergence of new distribution options for the entire industry. Digital services that do not require performance rights or non-statutory mechanical rights in music publishing would still come up against Universal, as the dominant player in recorded music, while services requiring performance rights licenses or non-statutory mechanical rights licenses would need to deal with both Universal and Sony, on each company's own terms, in order to launch a viable service.
Access to the content of the majors remains indispensable to building new distribution models. It is not feasible to succeed on the basis of unsigned artists alone. The concentration of control of albums in the hands of a dominant player in a highly concentrated market poses a severe threat to competition and dynamic innovation in this space. As the majors gain greater leverage, alternatives and artists lose out.

The proposed merger would also likely lead to a net loss of jobs in the U.S. recorded music sector. While UMG has not publicly announced its plans to cut jobs post-merger, it stands to reason that the combined label would eliminate redundant positions, particularly for departments like physical distribution and licensing that do not need duplicate departments elsewhere in the same label. Past experience supports this; for example, the Seagram/Polygram merger resulted in 3,000 job losses.

A Combined UMG/EMI Would Harm Independent Labels and Unsigned Artists

By leveraging its 41% market share against digital distributors, a post-merger UMG-EMI record label could stifle the development of services that would help independent labels or unsigned acts compete against the major labels. With the advent of digital platforms, many of the services that set major record labels apart from their smaller competitors are becoming irrelevant. A major label's ability to get the right consultant to convince a radio programmer to play a new release on the air is simply not as valuable in a world where more and more consumers use online radio services like iHeartRadio, Pandora, and Songza. Major labels' relationships with brick-and-mortar stores are not as useful when so many sales are made online, and services like CD Baby help independent artists promote and distribute their works. A major label's special connections to promote an album are less necessary now that an artist can build a fan base using social media or online advertisements. Finally, artists are increasingly willing to record their own songs using new technology rather than wait for a major label contract to release their first LP. Although these developments are obviously disruptive to

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[9] *Billboard Hot 100*, http://www.billboard.com/charts/hot-100 (last visited Feb. 29, 2012).
[10] *Id.*

the more traditional major labels, they are a welcome boon to independent labels and unsigned artists, who are for the first time enjoying a much more level playing field than the music business has ever seen.

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

A dominant major label could also license its copyrights to a new digital distributor, but demand equity in the distributor, payments in excess of its true market share, burdensome advance royalty payments, or exclusivity in return. For example, Beyond Oblivion, a digital music service founded in 2008 and backed by News Corp. and Allen & Co., aimed to provide users with a nearly unlimited selection of music on devices that held Beyond Oblivion software. The service filed for bankruptcy in late 2011 before it had even launched. Notably, bankruptcy proceedings revealed that Beyond Oblivion owed outstanding debts of $50 million each to Sony Music Entertainment and Warner Music Group—an astonishing figure for a service that was never actually used by a single customer. These kinds of high advance royalties can hinder a digital startup from launching a successful and sustainable product. They also discourage investors, who must shoulder higher levels of risk for any digital music distribution service that requires direct licensing from record labels.

The sustainability of independent labels benefits artists, either those who decline to partner with a major label or those who seek to develop their career to make themselves more attractive to a major label. For example, Justin Bieber likely would not have been able to become the phenomenally successful recording artist he is today if digital platforms and independent labels had been squeezed out of the market. Bieber's career began when his mother posted videos of him singing (unlicensed) covers of R&B hits on YouTube. Bieber's videos caught the attention of talent manager Scooter Braun, and he was soon signed to the independent label Raymond Braun Media Group (RBMG). Bieber later released his albums through the Island Def Jam Media Group, a label owned by UMG, but he was initially discovered and guided into the music business via YouTube and an independent label. Without unaffiliated platforms and smaller labels, similar break out stars may never reach their audience.

But the progress of Justin Bieber's career, although unusual in magnitude, is not so different in kind from the development of every musician's career. Whether they hope for a contract with a major label or independent label, or plan to never sign to any label, musicians develop their skill and talent by creating more, playing more, and reaching more fans. Today, that process includes using new digital platforms in addition to practicing at home, playing small venues, and making DIY recordings to give to fans or

A&R representatives. These digital platforms are a necessary part of the development of many of today's musicians.

Rather than Innovate UMG Has Opted to Consolidate and Litigate

In reviewing this proposed merger, the antitrust authorities cannot ignore UMG's past conduct and the likely negative impact on innovation. UMG has demonstrated an adversarial approach to new online services that might disrupt the major labels' current business models and has focused heavily on consolidation to gain market power.

For example, Universal sued the video site Veoh early in its creation for copyright infringement. Despite the fact that Veoh was lawful and ultimately won in court, the litigation bankrupted the company and hamstrung its potential. This pattern of litigation rather than innovation continues unabated today. Last year Universal was the first of the major labels to sue the streaming music service Grooveshark, and Universal sued the streaming service Deezer in France after the company refused Universal's demand that it limit its freemium tier to five consecutive songs. Luckily, the French courts agreed with Deezer, holding that Universal's behavior was "an abuse of a dominant position." In 2006, Universal sued MySpace for its users' copyright infringement, and even brought a suit against Grouper.com, which was owned by fellow major label Sony.

Instead of meaningfully working with innovative new digital music services, Universal has focused on a strategy of acquiring and consolidating with other record labels. Universal has bought Geffen Records, DGC Records, Universal Republic Records, Univision Music Group, Impulse! Records, and V2 Music Group, to name just a few. In 1998, Universal's parent company Seagram also bought and merged the PolyGram label, which itself had already purchased Island Records, Interscope Records, Def Jam Recordings, Motown, Mercury Records, Mercury Nashville, Verve Records, and Polydor Records, among others. Seen in this light, Universal's bid for EMI is just one more step in a concerning decades-long trend of consolidation in the recorded music business.

As a result of its already dominant position in the market, the times when UMG has struck licensing deals with new services has included terms that impaired competition. For example, when UMG licensed its catalog to wireless service provider Reliance Communications, it did so on an exclusive basis, thereby preventing any substitute service from entering the marketplace that would give consumers a choice between services.

The Merger Fails Under Traditional Antitrust Analysis

The antitrust laws are intended to protect innovation and competition, and to prevent firms from using their market power to arbitrarily raise prices for consumers. Traditional antitrust analysis shows that the UMG-EMI merger contains significant competitive harms, particularly in light of the merger's potential effects on the development of new digital music distribution models. The merger must therefore be scrutinized closely and its harms must be remedied in order to preserve a competitive, productive music distribution market.

The post-merger market share of the combined UMG/EMI entity would give it the power to distort the development of digital music distribution models or even determine the fate of new digital music services. UMG and EMI's combined market share of 41% would likely give it the power to veto emerging distribution models, and would certainly empower the combined entity to lead other record labels in doing so. With a post-merger three-firm market share of 90%, and with one or two companies following the lead of the dominant firm—here, UMG/EMI—the market would be vulnerable to anticompetitive harm resulting from conscious parallelism.

The Merger Guidelines

The recently-updated joint Department of Justice/Federal Trade Commission Merger Guidelines begin evaluating proposed mergers by analyzing concentration in the relevant markets, as measured by the Hirschman-Herfindahl Index (HHI). If a proposed merger would increase concentration in the market in a way that significantly increases the market power of the post-merger firm, then the merger warrants scrutiny. The threshold levels of concentration that demand scrutiny have recently been raised in the Merger Guidelines, making it all the more important that mergers that exceed the levels specified in the Guildeines be examined and remedied.

Under the revised Merger Guidelines, a moderately concentrated market is defined as a market that exhibits an HHI between 1,800 and 2,500. A market with an HHI below 1,800 is considered unconcentrated, and a market with an HHI above 2,500 is considered highly concentrated. To give a frame of reference, an HHI of 2,500 is the equivalent of a market containing four equal-sized firms, while an HHI of 1,000 is the equivalent of a market containing ten equal-sized firms.

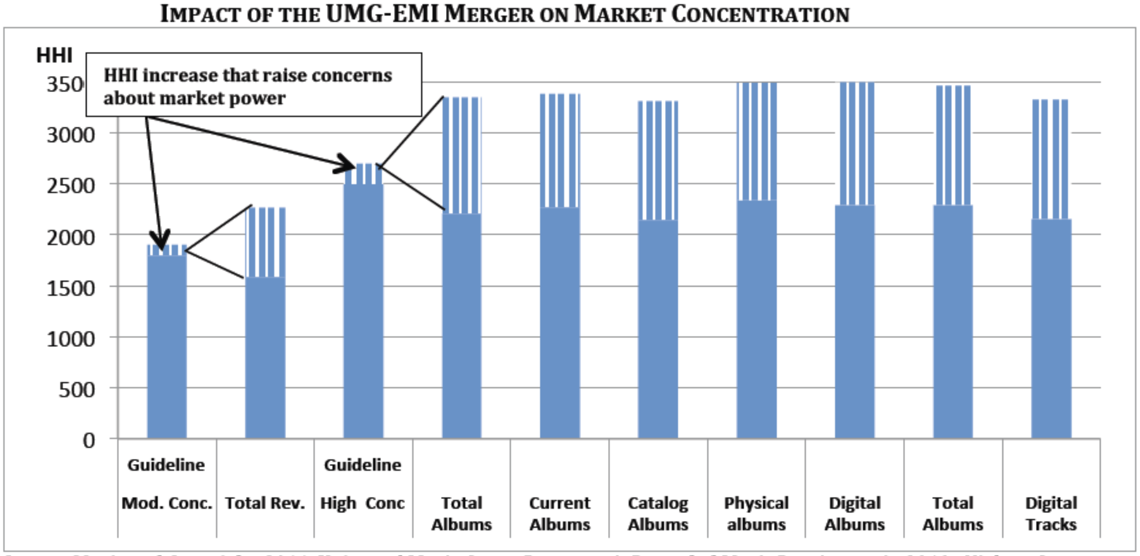
The Merger Guidelines recommend different levels of scrutiny of a merger based on the pre-merger level of market concentration and the extent to which the merger would increase concentration in the market. Merges that will increase the HHI by more than 100 points and result in moderately concentrated markets potentially raise significant competitive concerns and often warrant scrutiny. Mergers that will increase the HHI by 100 to 200 points and result in highly concentrated markets potentially raise significant competitive concerns and often warrant scrutiny. Mergers that will increase the HHI by more than 200 points and result in highly concentrated markets are presumed to be likely to enhance market power.

The UMG-EMI Merger Raises Significant Competitive Concerns

If allowed, the UMG-EMI merger would create levels of market concentration that raise "significant competitive concerns," and would thus warrant scrutiny from the antitrust authorities. Much like the failed proposed merger between AT&T and T-Mobile last year, this merger would also reduce the number of dominant firms in the marketplace from four to three.

When measured by record label revenues, this merger would increase the HHI of the recorded music market by over 500 points (more than five times the trigger under the Merger Guidelines), moving the market from unconcentrated to moderately concentrated.

IMPACT OF THE UMG-EMI MERGER ON MARKET CONCENTRATION



Source: Music and Copyright, 2011, Universal Music Group Reasserts it Recorded Music Dominance in 2010; Nielsen Company & Billboard's 2011 Music Industry Report, Department of Justice, Federal Trade Commission *Merger Guidelines,* June 2010.

When measuring only the market for albums, which is the largest single source of record label revenue, the levels of market concentration are even worse. For albums, the merger would increase the HHI of the marketplace by 1,000 points, moving the market from moderately concentrated to highly concentrated. This is *five times* the level at which the Merger Guidelines state that a merger will be "presumed to be likely to enhance market power."

Based on 2010 year-end figures, the four major record labels account for almost 90% of recorded music sales in the U.S. UMG is the largest company, with a share of 30.8%, followed by its nearest competitor, Sony (at 28.0%), then Warner Music Group (WMG) (20.0%), and EMI (10.2%).[11] This leaves only an 11.0% market share for independent labels.[12] The combined UMG/EMI entity would control 41% of the market, and the three-firm concentration ratio would reach almost 90%. This situation raises serious concerns that the top three labels will coordinate or engage in conscious parallelism that reinforces the lead of the dominant firm.

Other aspects of this merger only increase concerns under antitrust analysis. The top four to six firms in the market have remained remarkably stable for the past 25 years, despite an unprecedented technological upheaval. This kind of stability raises concerns

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[11] Alice Enders & Ben Rumley, *EMI: The Game of Music Chairs Continues*, ENDERS ANALYSIS at 6 (Dec. 7, 2011).
[12] *Id.*

that the dominant companies have entrenched themselves and that barriers to market entry prevent new companies from competing with the incumbent labels. As discussed earlier, these particular labels have a history of anticompetitive, anti-consumer conduct that resulted in two settlements less than ten years ago.

Lastly, EMI is not a "failing firm" under antitrust analysis, and so the antitrust authorities cannot permit anticompetitive harms that would otherwise be prevented by antitrust law. A failing firm must be in imminent danger of financial failure and unable to reorganize under Chapter 11 of the Bankruptcy Act, and the firm must have made good-faith efforts to find a viable alternative that would avoid anticompetitive harms. In recent years EMI has seen very stable revenues, and EMI's profit margins have risen steadily from 5.6% in 2007-08 to an industry-leading 17% profit margin in 2010-11.[13]

Piracy Does Not Discipline the Major Labels from Raising Prices

Claims that the piracy will prevent anticompetitive harms should the merger be consummated are belied by empirical analysis of the prevalence of infringement in the music business, and by the major labels' own prior conduct. Last year alone, consumers spent almost $2.5 billion on digital music products, showing a strong desire by consumers to access music legally. If consumers today are willing to pay an average of $10.40 per digital album, why would they suddenly resort to piracy if the price went up to $11?

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

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

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[13] Alice Enders & Ben Rumley, *EMI: The Game of Music Chairs Continues*, ENDERS ANALYSIS at 4 (Dec. 7, 2011).

schemes would have been unprofitable because they would have driven more consumers to infringe.

As Public Knowledge and the Consumer Federation of America examined in depth in our recent white paper on the UMG-EMI merger, studies indicate that piracy has had much less impact on the recorded music market than the merger proponents now claim.[14] Indeed, for some demographics, unauthorized downloads act as promotional materials and actually increase legal purchases of music. Studies also indicate that the most efficient way to decrease copyright infringement is to increase the availability of reasonably priced legal alternatives—exactly what UMG-EMI will be less motivated to do if the merger is approved.

Conclusion

Competition among production and distribution intermediaries in the music industry ultimately gives more choice to musicians and leads to better market offerings for consumers. Competition increases the diversity of choices for consumers, empowering consumers to choose the services that best fit their needs at the best price. If one or two major labels obtain enough influence to stifle the development of new digital music services, those services never will be able to gain traction in the marketplace, and potential competitors will fail, not on their merits, but based on the service's inability to strike a deal with an inordinately powerful supplier. As a result, both musicians and audiences will suffer for lack of innovative competitors in the online music service marketplace.

We therefore are concerned that allowing this transaction to proceed not only will thwart burgeoning digital music innovations, but will also potentially drive up prices and minimize choice for consumers. The merger must therefore not be allowed to proceed.

[14] Mark Cooper and Jodie Griffin, *The Role of Antitrust in Protecting Competition, Innovation and Consumers as the Digital Revolution Matures: The Case Against the Universal-Emi Merger and E-Book Price Fixing* (June 2012).