



Blackstone
CHAMBERS

THE EC COMMISSION AND RECORD INDUSTRY MERGERS

**The text of a speech delivered by Ian Mill QC to the International
Association of Entertainment Lawyers at MIDEM 2006**

Introduction

The EC Merger Regulation has the effect that any proposed merger of two major record companies will only be achievable if the concentration to which such a merger gives rise is found by the EC Commission, on investigation, to be compatible with the common market and the functioning of the EEA Agreement.

Upon such an investigation, the EC Commission enquires as to whether the proposed concentration would create or strengthen a dominant position, as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it.

As you will be aware, the recorded music businesses, but not the music publishing, manufacturing or distribution businesses, of BMG and Sony merged in 2004. This merger was rendered possible by the decision of the Commission in July of that year that the proposed merger was, following investigation, compatible with the common market.

I propose to summarise the reasoning of the Commission and, by putting its decision in an historical context, to seek to make some observations about how another such proposed merger might be received in the future.

The Commission's Decision

First the decision itself. It is important to recognise, at the outset, that the Commission was concerned with the possibility of two different types of dominant position. The first was any single dominance which would be created by the merger. The second was the creation or strengthening of any collective dominance of an oligopoly – namely, the majors as a collective unit.

The Commission's primary concern in relation to Sony and BMG appears to have been the latter type of dominant position - in particular whether the effect of the merger would be the creation (or strengthening) of a common policy among the members of that oligopoly involving selling at above competitive prices.

Such a finding by the Commission would have required the satisfaction of each of three conditions:

- (1) that the coordinating firms were able to monitor the terms of coordination adhered to;
- (2) that there was a form of mechanism to deter any of the coordinating firms from deviating from the common policy; and
- (3) that the reaction of other competitors in the market and customers would not be able to jeopardise the results expected from the coordination.

The Commission investigated whether there was evidence of a coordinated price policy among the majors having effect in the common market. It found some, but in the view insufficient, evidence of coordinated historic pricing behaviour. None of the three conditions was found to have been satisfied.

The Commission then went on to consider whether the effect of the proposed merger would be to create in the future a collective dominance where none had previously existed – given the reduction in the number of members of the oligopoly from 5 to 4.

The Commission concluded that there was insufficient evidence that this reduction in numbers represented a change substantial enough to result in the likely creation of collective dominance.

The Commission also considered other possible dominances, each of which it also concluded was not established on the evidence before it:

- (1) A single dominance on the basis of the merger entity's vertical relationship to Bertelsmann.

The Commission's concern was that Bertelsmann could use its position in TV and radio stations to foreclose competitors and favour Sony BMG - in particular by granting preferential rates to Sony BMG for advertising and/or by preferring artists from the Sony BMG stable and/or even by excluding the competition from advertising or promoting on air.

- (2) A collective dominance of the majors on the wholesale market for licences for online music.

The Commission's concern was pricing policy coordination in the field on online licensing.

- (3) A single dominance of the online platform, Sony Connect, in the markets for distribution of online music.

The Commission's concern was that the merged entity could foreclose competitors in the downstream market for distribution of online music by denying competing platforms access to the Sony BMG library. It was argued that the incentive for such a foreclosure would follow from Sony's activity in digital portable music players.

Finally, the Commission considered whether the merger would have as an object or effect the coordination of the competitive behaviour of BMG's and Sony's respective music publishing businesses, which were to remain independent. The Commission concluded that there was no evidence of such an object, nor was it considered that this was a likely effect - in particular, because there was little opportunity to coordinate given the involvement of collecting societies.

Historical Context

A striking feature of this decision is that it followed on from a similar investigation in the same sector with rather different consequences. In May 2000 Time Warner and EMI notified the Commission of a proposed merger of its businesses. The Commission published a press release stating its intention fully to investigate that merger as a result of three concerns:

- (1) That it would lead to an oligopoly of four firms controlling some 80% of the market in the EU.
- (2) That it would lead to a single dominance in music publishing.
- (3) That it would lead to dominance in delivery of online music, in particular given the impending merger between Warner and AOL.

In contrast to the outcome of the Sony BMG notification, EMI/Time Warner voluntarily withdrew their notification prior to the Commission's decision. Although no reason was published, one can readily infer that the outcome of the investigation was not looking positive. Indeed, the negative views of the Commission have been widely referred to.

Why the different outcome in 2004, and what might happen if there were a second notification by these companies?

I would suggest that a very important event occurred between the two notifications. The Commission had, in 1999, considered the notification of a proposed merger before two UK tour operators – Airtours and First Choice - and had declared that concentration incompatible with the common market. In June 2002, the Court of First Instance gave its decision on Airtours’ application for annulment of that decision. In a blistering and savage judgment running to some 300 paragraphs, that Court found fundamental flaws in almost all aspects of the Commission’s reasoning. It concluded that the Commission’s decision:

“far from basing its prospective analysis on cogent evidence, is vitiated by a series of errors of assessment as to factors fundamental to any assessment of whether a collective dominant position might be created....”

At the heart of those criticisms lay the point that, to prohibit a transaction, the fact of an anti-competitive dominance has to be proved by convincing evidence.

One observation would therefore be that, following Airtours, the Commission was going to be, and is likely hereafter to be, far less ready than before to find such evidence established and therefore to prohibit notified transactions – and this may in part at least explain the favourable outcome for Sony BMG. Moreover, the approach of the Court of First Instance in Airtours was reinforced by the European Court of Justice in 2005 in Tetralaval, when it emphasised the need for the Commission to carry out any analysis of any prospective possible dominance with great care.

Accordingly, any future notification by EMI and Warner might be received with less hostility than on the previous occasion. I would venture three further points about any such notification:

- (1) It will have been noted that Sony and BMG kept their music publishing businesses out of the merged entity. EMI/Warner are in a more dominant position in that field of activity and any renewed notification by them will have to address that issue.
2. The analysis by the Commission of possible dominance in online activity noted that this business was very much in its infancy, and the Commission's findings were based on a lack of evidence at that stage. Any future notification by EMI/Warner would be subject to greater empirical scrutiny and will also have to take into account the merger (which was permitted by the Commission, subject to undertakings) of Warner/AOL.
3. The Sony BMG Commission decision is subject to an outstanding application for annulment by a trade association of independent record companies – IMPALA. The Court of First Instance heard that application in September 2005. Its ruling is awaited (probably in the first half of this year). One of the grounds of the application was that the Court did not consider all aspects of how the merger would affect competition – including the threat which the merger posed and poses to European cultural diversity. It is certainly the case that the Commission's decision considered coordination primarily from the perspective of price, and it did not (for example) consider any impact of the proposed merger on artist contracts – an area which was the subject of objection before the Commission.

“Cultural diversity”, and its relevance in this context, is a topic which others on this panel are far better qualified than I to discuss. I shall leave it to them to do so now.