EUROPEAN COMMISSION
Competition DG
Information, communication and multimedia
Media and music publishing
The Head of Division

Brussels,
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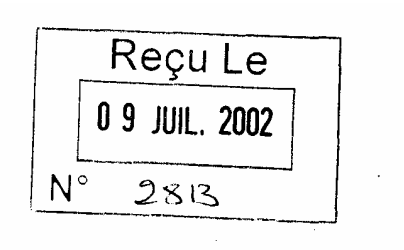


Registered with advice of delivery

BIEM
22-26, boulevard du Parc
F-92200 Neuilly sur Seine
France

Subject: Case COMP/C2/38.440 Universal v BIEM
(Please quote reference in all correspondence)

Dear Sirs,

Please find enclosed copy of the complaint submitted to the European Commission by Universal Music International Limited against BIEM.

You may submit to the Commission comments on the complaint. Should you wish to do so, please submit your comments within four weeks from reception of this letter.

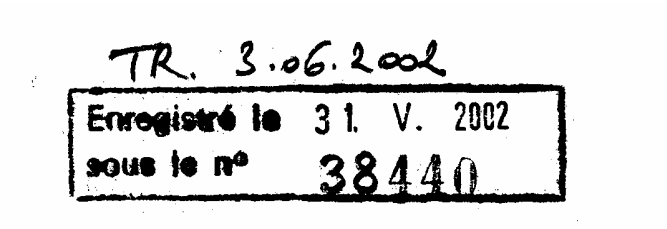
For any question regarding this matter you may contact Mr. Miguel Mendes Pereira (tel. +32.2.296.69.77; fax +32.2.296.98.04; e-mail Miguel.Mendes-Pereira@cec.eu.int).

Yours faithfully,

Dr. Herbert UNGERER

Enclosed: complaint by Universal Music

Non-Confidential Version



COMPLAINT BY UNIVERSAL MUSIC INTERNATIONAL LIMITED

TO THE EUROPEAN COMMISSION

CONCERNING THE LICENSING OF MECHANICAL REPRODUCTION RIGHTS

31 MAY 2002

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CONTENTS

Annex 7	Letter from Cees Vervoord of BIEM to Jason Berman of the IFPI dated 27 June 2000
Annex 8	Current Weighted Average Mark-Up (CD's)
Annex 9	Summary Sheet setting out Universal's methodology relating to calculation of appropriate royalty rate
Annex 10	Correspondence Between BIEM and IFPI concerning the actual realised price work undertaken by PWC
Annex 11	Correspondence relating to attempts at national negotiation outside the terms of the Standard Contract
Annex 12	The Swiss Competition Authority Opinion
Annex 13	IFPI Press Releases: "Artists and music industry leaders urge action to tackle fastest-growing piracy problem in Europe" dated 24 April 2002 and "Global Music Sales down 5% in 2001", dated 16 April 2002
Annex 14	ABN-AMRO's review of the Global Music industry, dated 24 January 2002
Annex 15	Copy of "JASRAC Now" Article with Unofficial Translation
Annex 16	LECG Economic Analysis: Worked examples relating to the economic impact of discounts, minimum royalties and maximum tracks
Annex 17	Proof of Authority to Act

COMPLAINT BY UNIVERSAL TO THE COMMISSION OF THE EUROPEAN COMMUNITIES CONCERNING THE LICENSING OF MECHANICAL RIGHTS

INTRODUCTION AND SUMMARY OF COMPLAINT

1.1 This Complaint is made, pursuant to Article 3 of Council Regulation 17/62 (Regulation 17), by Universal Music International Limited ("Universal"), a subsidiary of the Vivendi-Universal Group, against the Bureau Internationale des Sociétés Gérant les Droits d'Enregistrement et de Reproduction Méchanique ("BIEM") and its relevant collecting society members, (as set out at Annex 1) regarding the terms upon which BIEM and its members contract in relation to the licensing of mechanical reproduction rights in the EEA, excluding the United Kingdom and Eire ("the BIEM Area").1

1.2 As the Commission knows, mechanical reproduction rights are rights accorded to authors and composers under national copyright laws in respect of their musical works. It is invariably the case however, that for administrative and management purposes, authors and composers transfer all or part of the original copyright to music publishers who in turn, (and usually for the same reasons) often transfer the rights to collecting societies. Mechanical reproduction rights are licensed to record companies generally by these collecting societies primarily for the reproduction of sound recordings (mainly CDs and music cassettes).

1.3 This Complaint sets out why Universal considers that certain provisions of the standard licensing agreement (the "Standard Contract") establishing the terms on which relevant BIEM members (being those BIEM members who have agreed to apply the standard terms2, operated by BIEM under the Standard Contract (the "Relevant BIEM Members")) contract with record companies, including the standard rate (the "Standard Rate", being 9.009%3) established as a result of the operation of those terms, infringe Article 81(1) and/or Article 82 of the Treaty of Rome and Article 53(1) and/or Article 54 of the EEA Agreement[4]. Throughout this Complaint, references to Article

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1 Licensing terms in both the UK and Eire have been settled by domestic copyright tribunals under domestic legislation.

2 See Annex 1 for a list of the Relevant BIEM Members.

3 See paragraphs 4.7-8 for details of how this Rate has been calculated.

4 The Standard Contract is at Annex 2

81(1) shall include references to Article 53(1) of the EEA Agreement and references to Article 82 shall include references to Article 54 of the EEA Agreement.

1.4 Universal would emphasise at the outset that it is not attacking in this complaint the existence of the Standard Contract or collective licensing per se, both of which Universal considers to be essentially capable of operating in a pro-competitive manner and worthy of exemption from Article 81(1) by reference to the criteria in 81(3), (see below). Equally, Universal recognises and accepts that the Commission is unlikely to resolve the matters addressed in this Complaint by settling on a particular royalty rate and Universal is not asking the Commission, by means of this Complaint, to do so. Universal would, however, note that the Commission has demonstrated recently a preparedness to intervene when it considers uniform industry rates or standards established by horizontal agreements between undertakings produce anti-competitive results; for example, recent Commission actions in relation to the multilateral interchange fee operated by the Visa association of undertakings.[5] In the same way that it appears that the Commission has been able to ultimately reach a positive conclusion in the Visa case, in principle, a standard contract for the collective licensing of mechanical rights throughout the BIEM Area is capable of operating as a pro-competitive instrument in terms of delivering a BIEM Area-wide solution to the licensing of mechanical rights and is also capable of maximising efficiency gains in the administration of these rights, provided its terms and the resulting rate are proportionate and do not prevent, restrict or distort competition; that is, provided it operates in a manner consistent with Article 81 in general and the exemption criteria of Article 81(3) in particular. In this regard, Universal recognises that although the BIEM Statutes, which establish the terms on which BIEM and its national monopolist members operate, (in particular Article 7 of these Statutes which provides that BIEM members will not operate in contravention of these terms6) render BIEM a monopolist in respect of the negotiation of mechanical royalties and as such, an unavoidable trading partner throughout the BIEM Area, this arrangement is nonetheless *potentially* capable of being consumer and / or industry beneficial, by facilitating and enhancing

[5] Universal refers in this regard to the Commission's Article 19(3) Notice with respect to Visa International (11 August 2001 Case Comp/29.373) where the Commission indicated that in return for a standard charge implemented by Visa's members being reduced to a fair and proportionate level and the introduction of objective benchmarks against which to assess the charge, the Commission would be prepared to take a positive decision in respect of the Visa membership and operational rules.

efficiencies in the pan-European licensing and management of mechanical rights, *provided* the rents sought by BIEM for the licensing of the rights are reasonable and the restrictions are no more restrictive than strictly necessary; that is, both rents and terms represent no more than that which a willing licensor and willing licensee would agree, each bargaining on equal terms. *As currently operated,* the practical effect of the terms and resulting rate of the Standard Contract are not fair and proportionate and these anti-competitive effects are reinforced by Article 7[6], which renders impossible any alternative competitive solution, through national negotiations between individual BIEM members and record companies or other users. (In this regard, the Commission should note that Universals comments in relation to Article 7 should not be taken as an attack on BIEM in its entirety, since dismantling BIEM would not resolve the concerns raised in this Complaint as the national societies remain dominant in their respective territories).

1.5 As the Commission is aware, this is not the first time that concerns regarding the Standard Contract have been brought to the Commission's attention. In this regard, Universal recognises that the Commission accepts that in principle, a pan-European model can produce a positive, competitive outcome. However, where, by virtue of its structure and internal operational rules, a licensing body presents itself as a monopolist, it must be incumbent on the relevant competition authority to ensure that the licensing terms are consistent with the competition rules and that generally, the arrangements produce a competitive outcome, consistent with current market conditions. In this regard, it is submitted that where, as in the case of BIEM, the Standard Rate[7] was settled 50 years previously, it is important to ensure that those terms are consistent with current market conditions and commercial usage. The Commission is therefore urged to approach this Complaint by

- analysing the relevant contractual provisions in a manner consistent with its practices in all other sectors;
- considering the compelling economic case made in this Complaint;

[6] See paragraph 2.2.7 below for further details of the terms and requirements of Article 7.

[7] See paragraphs 4.6 onwards for details of the history of this Standard Rate and how it has been calculated.

- taking full account of current market condition comparables elsewhere in the world; and
- having full regard to how the relevant markets impacted by the BIEM structure have changed and developed, both generally and specifically since 1930 in relation to the production, marketing and distribution of sound recordings.

1.6 Universal understands from a recent meeting with the Commission that the Commission issued a comfort letter in respect of a notification of the BIEM Statutes. It is further understood that no Notice pursuant to Section 19(3) of Regulation 17/62 was published in relation to this notification and third parties were generally not consulted during this process. It would therefore appear that the Commission was not informed at the time of that notification of all the relevant factual circumstances surrounding the practical operation of Article 7 of the BIEM Statutes, as more particularly described in this Complaint.

1.7 Whether or not Article 7 has an anti-competitive object, for the reasons set out in this Complaint by Universal, the practical effect of this Article is to foreclose all competition between BIEM members, thereby reinforcing the anti-competitive effects of a number of provisions of the Standard Contract.[8]

1.8 Against this background, it is Universal's submission that the current terms which make up the Standard Rate and, in turn, the royalty rate itself, infringe Article 81 and 82. In particular, the terms to which Universal object are:

(i) the current level of the Standard Rate;

(ii) the contractual provisions relating to the Standard Contract, in particular, the current, unrealistic operation of the discount and mark-up components;

(iii) the contractual provisions relating to and the current unfair and inflexible operation of minimum royalties; and

(iv) the contractual provisions concerning maximum tracks and playing time.

1.9 Universal considers that the BIEM structures and operations enable BIEM to behave independently of

[8] See, by way of analogy, Case T-241/97 *Stork Amsterdam* at paragraph 80 and Case T-279/95 *Langnese-Iglo v Commission* at paragraph 30
Ministère Public v Tournier, ECR 2521.

any competitive restraint and thereby enable BIEM to impose upon users, such as Universal, contractual terms which are inconsistent with current commercial usages and which appreciably prevent, restrict or distort competition. The relevant contractual terms and the Standard Rate maintained by these contractual provisions at present, establish price levels which are currently the highest in the world and which have the clear effect of limiting technical progress, consumer choice and the production and sale of goods in an anti-competitive manner. Clearly, comparables constitute one accepted proxy for assessing whether royalty rates charged by collecting societies may be excessive, as recognised by the Court of Justice in the Tournier case[9] and more recently by the Commission in the Visa decision referred to above[10]. In the present context, since the current Standard Rate forecloses price competition between societies in the BIEM Area, it is legitimate to look at comparables elsewhere in the world; what this exercise shows is that elsewhere the rates are markedly lower than the rate imposed by BIEM. (It will be observed from the table of comparisons set out at Annex 3 that the BIEM Rate is clearly the highest in the world;, in Australia the rate is 8.7% of PPD, in Japan, it amounts to an estimated 7.18% of PP[11] and in South Africa, 6.76% of PPD). These rates are comparable to the Standard Rate and there are no objective, relevant dissimilarities, or any other reasonable grounds for the Standard Contract to impose a higher rate than anywhere else in the world. Since the United States applies a penny rate (i.e. a charge per track) it is problematic to produce a rate comparison. However, a comparison of the mechanical rate costs to Universal's record company as a percentage of its turnover between the BIEM Area and the United Sates shows the cost to be lower in the United States. We should infer from this that should the United States apply a percentage rate, it would be lower than the BIEM rate.[12]

1.10 Universal would emphasise, within this context, that the matters complained of as regards licensing terms and royalty rates are not merely a consequence of a dispute between a monopoly

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9 Ministère Public v Tournier, [1989] ECR 2521.

10 In this case, the Commission looked at the position in other countries, including Australia, to compare the position and determine whether or not the basis and calculation of the multilateral interchange fee in the EU was reasonable and fair.

11 This estimated figure is based on a retail rate of 6%, converted to a PPD base rate on an assumed mark-up of 30% in the Japanese market.

12 A worked comparison is set out at Annex 3.

supplier/licensor and its customer/licensee, but rather produce serious consumer detriments by leading to higher prices, reduction in consumer choice, limitations in output and availability of certain types of sound recordings and on the number of tracks appearing on such recordings. In particular, (as explained further in this complaint):

- the Standard Rate is unfair;
- the continued and unjustified application by BIEM of an arbitrary level of mark-up on PPD which was once applicable in 1985 no longer reflects market realities. BIEM has historically maintained that this level of mark-up should remain and has refused to negotiate a lower mark-up that would reflect the actual level of mark-up applied by retailers in the market, despite direct, uncontradicted evidence that the level of mark-up has since decreased very significantly;
- the imposition of arbitrary contractual discount structures originally fixed by reference to market conditions which have not prevailed for many years. In this context, the arbitrary basis for calculation of discounts contained in the Standard Contract enables BIEM and its members to dictate, to a significant degree, the pricing strategy of record companies and reduce their ability to lower and be more flexible with their prices. This has a clear knock-on effect on the price which the consumer is charged. If record companies are forced to pay disproportionate royalties to the Relevant BIEM Members and at the same time need to cover their own costs and make some margin in an increasingly competitive market place, the price to consumers is likely to be unnecessarily and unfairly inflated. Equally, it is unfair and abusive to require record companies to pay royalties to BIEM and the Relevant BIEM Members on income not received by record companies, whilst at the same time, BIEM itself remains insulated from competitive pressures.
- the current, unfair level of minimum royalty obligations imposed on the record companies under the Standard Contract has the effect of inflating the level of royalties in relation to categories of sound recordings which are particularly price sensitive, thereby limiting the price competitiveness of certain types of music products and their overall availability to the public at large. This distorts the normal distribution of low-priced records and prevents record producers from setting prices according to market conditions so as maximise sales of each category of products;

- the maximum track limitations, also imposed by the provisions of the Standard Contract, have a substantial, negative impact on the production of sound recordings (predominantly CD's) which include a large number of tracks (such products being especially attractive to consumers since, inter alia, they represent value to consumers by virtue of the large number of tracks included). Where the threshold number of tracks imposed by the Standard Contract is exceeded, provisions within the Standard Contract permit BIEM to increase the royalty rate payable, with the effect that there may be a negative impact on pricing, since the lowered margin restricts Universal in its pricing flexibility; a further negative impact on product availability also results, since certain products may not be released by Universal because it is not economically viable to do so due to this significant increase in royalty rate; thus Universal is unable to be creatively flexible in relation to the format and contact of certain products. This in turn creates an economic deterrent to production of certain types of sound recordings, with the practical result that the provisions discriminate against the production of those types of recordings. The limitation on the number of tracks on an album is therefore, in Universal's view, clearly devoid of any reasonable economic justification;

- one of the effects of the current minimum royalty provisions and the maximum track/playing times provisions of the Standard Contract, is that they effectively leave the Relevant BIEM Members in a position whereby they can dictate how record companies must run their businesses, since they render economically unattractive the production of certain types of product. This constitutes an illegitimate interference by BIEM in its customers' commercial operations. Moreover, the current minimum royalty provisions and maximum track/playing time provisions have the practical consequence of increasing the Standard Rate of 9.009% by a further, approximate, 0.2%; the result being that the actual Standard rate is more like 9.2% and the cost of this to Universal alone represents approximately *[confidential business secret]* per annum.[13] There is no commercial or economic rationale for such interference, with its correspondingly negative impact, as described in this Complaint;

[13] See paragraphs 4.7 to 4.17 for a detailed discussion of the inappropriateness of the level of the Standard Rate.

- calculation of the rate by reference to a percentage of actual or average realised price[14] would result in a more equitable outcome for both record companies and collecting societies and their members, since such a methodology reflects market realities. Provisions such as minimum royalties and maximum tracks serve unfairly to effectively cushion the Relevant BIEM Members against the negative consequences of economic downturn; yet in an economically thriving market, (due in particular, to the minimum percentage calculation), BIEM and its members also have the advantage of sharing in the positive effects of increased sales. BIEM and its members are therefore able to act entirely independently of their customers, ignore current market conditions and therefore operate without competitive constraint. As a result, BIEM can ignore the market conditions which constrain all others operating in the relevant affected market; a fact that is clearly illustrated by a speech given by the President and Chief Executive Officer of the German collecting society and BIEM member, GEMA, on 27 June 2001[15]. In section 4 of this speech, the President of GEMA observes that whilst all other areas of the music industry are suffering as a result of the economic downturn and issuing profits warnings:

  "All the figures ... indicate that GEMA will achieve at least the same numerical result for [2001 as] for the year 2000. So far as GEMA is concerned, there are no grounds for issuing the profit warnings that we unfortunately hear, not only from all sectors of the media industry, but also from the industry and business in general, with their fears of imminent recession .... To put it plainly, GEMA members and all rights-holders can once again expect returns of more than DM 1 billion 570 million for the year 2001 and amounts of more than 1.34 billion to be distributed accordingly.";

- all of these offensive provisions of the Standard Contract operate to the detriment of consumers: not only do consumers pay more for sound recordings as a result of the operation of the provisions, but their choice becomes more limited and in some cases, is foreclosed, because it is not economically attractive for record producers to produce certain categories of products at competitive prices because of the disproportionately high level of

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[14] See in particular, paragraph 4.8 onwards for more detailed discussion of actual and average realised price.

[15] A copy of this speech may be found on the web-site of GEMA at www.gema.de/encj/information/speech_gm2001.shtml

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royalties which such products must bear. Furthermore, the increased costs that record companies bear in producing products are also necessarily shared to a large extent by consumers. More generally, one of the stated aims of the European Union is to encourage cultural diversity and the development of its creative industries. Reduction in the Standard Rate, proper and fair application of, or abolition of, the minimum royalty provisions, abolition of the maximum track provisions and recognition of actual discounts would greatly benefit the music industry in Europe, which in recent years, has seen national (i.e. French artists in France, Spanish artists in Spain) rather than international music constituting an increasing percentage of the music sold in Europe. This is also consistent with the fact that the European Union is pledged to support small and medium-sized entities which tend to focus on national repertoire. These companies will be amongst those who would benefit from the proposed changes to the Standard Contract;

- the unfairness of the Standard Rate, as described in this Complaint, is exacerbated in the case of singles (product no longer than 23 minutes or containing no more than 5 tracks). Approximately *[confidential business secret]%* by value (and *[confidential business secret]%* by volume) of Universal's turnover in the BIEM Area is derived from the sale of singles. A key purpose of the singles is their promotional value for sales of the albums from which they derive and few singles are profitable themselves. To have to pay the same percentage royalty on singles as on full-length product is unfair. His is recognised throughout the industry in artist and licence agreements where royalties for singles are routinely a significantly lower percentage than for albums. It is also true to say that the current minimum royalties levels and the inclusion of the maximum track provisions affect, to a disproportionate extent, percentage of production and sale of singles by record companies; thus reinforcing the anti-competitive nature of these provisions in practice.

1.11 The overall effect and practical operation of all theses provisions is to enable to BIEM to impose an inherently unfair Standard Rate upon users such as Universal[16]. This is of considerable economic and commercial significance. Research by the independent economics firm LECG illustrates the

[16] Further details of the operation of and background to the above outlined issues may be found in Section 4 of this Complaint. Universal's submissions concerning the manner in which these requirements infringe Articles 81 (1) and 82 are set out in Section 5 of this Complaint.

effect of the failure to take account of the discounts the record companies actually give as well as the effect of minimum royalty and maximum track provisions. Using actual data from Universal on the prices and costs of different types of CD, and making plausible assumptions about the responsiveness of demand to price, LECG has shown how these features of the royalty system can induce record companies to:

- price some recordings at mid-price which would otherwise have been issued at budget price;
- forego opportunities to issue some budget recordings altogether;
- issue albums, particularly compilations, with fewer tracks than they would otherwise contain; and
- grant smaller discounts to their customers than they would if royalties were based on prices net of actual discounts.

1.12 The worked examples in LECG's report show that these features of the Standard Contract make all parties worse off. Not only do the record companies obtain lower profits; less royalty, in total, flows to the publishers and authors, while consumers pay higher prices or receive products which they value less. The current royalty system is detrimental to all the parties involved and to economic welfare in general.

1.13 Universal would note that the licensing of mechanical reproduction rights represented in 2000 an annual cost to Universal of *[confidential business secret]* and an overall cost to the record companies operating in the BIEM Area of approximately €593 million[17]. Not only does this demonstrate the legitimate interest of Universal in making this Complaint, (within the meaning of Article 3(2) of Regulation 17) but it also demonstrates that there is a strong Community interest for the Commission to address the matters complained of so as to ensure that a competitive outcome can prevail in the licensing of mechanical rights in the EU in the future.

[17] This figure is based on IFPI estimated wholesale value of recorded music sales in the BIEM area for 2000. The methodology for reaching this figure is set out in Annex 6.

1.14 Whilst Universal has chosen to concentrate in this Complaint, as a matter of priority only, on the above-mentioned matters, there are a number of other provisions of the Standard Contract (such as restrictions on export and rates of bargain sales (being stock clearance or sales where a product is deleted)) which also infringe Articles 81 and 82 and which Universal reserves the right to add to this Complaint at a later date.

1.15 Finally, by way of introduction, Universal recognises that, whilst the Commission may not have fully recognised these matters arising from the Standard Contract, or at least felt a pressing need to examine them in the past, there is a very great practical need for the Commission to address them now. The question of appropriate licensing structures and models and the legality of licensing terms in similar contexts to the Standard Contract are all issues which appear to be under current consideration by the Commission. As the oldest model, the Standard Contract represents an important precedent which is invariably referred to as a starting point in other licensing contracts for authors' rights relating to the terms on which BIEM, the Relevant BIEM Members and users contract with each other; for example, in relation to many of the current issues surrounding licensing of authors' rights in an on-line environment, licensing agreements in respect of which are currently under negotiation and which, critically, take the terms of the Standard Contract as their starting point. In promulgating on-line rates, collecting societies have used the current off-line rate as a starting point and then added a substantial premium. Thus, resolution of these concerns is crucial to the development of distribution of music on-line. Given these implications, there is now a very considerable need for the Commission to take a position as to the compatibility of the relevant provisions of the Standard Contract, together with the Standard Rate to which they lead, with the EU rules on competition.

2 THE PARTIES

2.1 Universal

2.1.1 Universal's registered office is: 8 St James' Square, London, SW1Y 4JU, England.

2.1.2 *Activities of Universal*

2.1.3 As mentioned above, Universal is part of the Vivendi-Universal Group which is engaged in a variety of different business activities ranging from environmental services (including waste management, water and energy services), to telecommunications and television to publishing,

music and film. For more detailed information on the Vivendi-Universal Group's activities, Universal refers the Commission to the copy of Vivendi-Universal's annual report and accounts for 2000 and a press release summarising Vivendi Universal's 2001 results, attached at Annex 4 to this Complaint.

2.1.4 The Universal Music Group, of which Universal forms part, carries on the business of recorded music, music distribution and music publishing under the Vivendi-Universal corporate umbrella. It is active in discovering, developing and promoting artists across the full spectrum of music genres and considers itself to be one of the companies at the forefront of innovation, developing new methods to distribute, market, sell, program and syndicate music and music-related programming by exploring the potential of new technological platforms.

2.1.5 Universal carries out its recorded music business through subsidiaries in every Member State of the EEA with the exceptions of Luxembourg, Liechtenstein and Iceland.

2.1.6 Universal is a member of the International Federation of the Phonographic Industry ("IFPI"). The IFPI groups nearly 1490 member companies in 75 countries and incorporates a network of 46 national groups responsible for representing the industry's interests locally.

2.1.7 In Europe, most IFPI members apply the Standard Contract. IFPI represents member companies in the negotiation of the Standard Contract. As a result, Universal does not negotiate directly with BIEM. Universal is however a member of the IFPI Negotiating Committee. The Standard Contract becomes binding when the local Universal subsidiary signs with the local BIEM member. The background to the most recent BIEM negotiation is described at Section 4 below.

2.2 **Party against whom the complaint is made: *BIEM and the Relevant BIEM Members***

2.2.1 **BIEM is a** world-wide organisation, which groups 39 authors' societies. BIEM's members administer the mechanical reproduction rights of their own members.

2.2.2 The registered office of BIEM is: 22-26 Boulevard du Parc, 92200 Neuilly-sur-Seine, France.

2.2.3 A full list of the Relevant BIEM Members is included in Annex 1. These Relevant BIEM members comprise all societies responsible for the licensing and administration of mechanical copyright in the EEA, (with the exception of the United Kingdom and Eire), each of which is responsible in its

respective territory for the management of mechanical reproduction rights arising under the relevant national copyright legislation.

2.2.4 *Activities of BIEM*

2.2.5 The overall function of BIEM as expressed in Article 2 of the BIEM Statutes dated 18 September 1998 (produced at Annex 5), is stated as being:

> *"to group with a view to the efficient administration of recording and mechanical rights, societies administering, or having by their Statutes the capacity to administer, the said rights on condition that they be in possession of appropriate administrative machinery."*[18]

2.2.6 One of BIEM's stated main objectives is: *"to negotiate in the form of Standard Contract the text of contracts which the associated societies shall be called upon to conclude for their respective territories with producers of phonograms and videograms, on the basis of the equality of treatment of right owners..."*.[19] (Article 2(3) of the BIEM Statutes).

2.2.7 *Article 7 of the BIEM Statutes*

2.2.8 As already noted in the Introduction to this Complaint, Article 7 of the BIEM Statutes (referred to above at *inter alia* paragraphs 1.4 and 1.7) provides as follows:

> *"the associated Societies undertake to do everything in their power to achieve the objects of B/EM, to abstain from any act which might compromise it, to respect the provisions of the present Statutes and to carry out all decisions made by the official bodies."*[20]

2.2.9 The relevance of this Article in assessing the impact on competition of a number of provisions of the Standard Contract will be referred to frequently in this Complaint.

2.2.10 Article 7(4) of the BIEM Statutes provides for a very limited number of circumstances in which the Standard Contract may be departed from:

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18 "La Société a pour objet de grouper, en vue d'une gestion efficace des droits d'enregistrement et de reproduction mécanique, les Sociétés gérant ou ayant par leurs Statuts la capacité de gérer lesdits droits, a condition toutefois qu'elles disposent d'un appareil administratif approprié."

19 "de négocier sous forme de contrats types !e texte des contrats que les Sociétés associées seront appelées a conclure sur leurs territoires respectifs avec les Producteurs de Phonogrammes et de Vidéogrammes la base de l'égalité de traitement des ayants droit."

20 "Les Sociétés associées et les Sociétés adhérentes s'engagent a mettre tout en oeuvre pour atteindre l'objet du BIEM, a s'abstenir de tout ce qui pourrait le compromettre, a respecter toutes les stipulations des présents Statuts et a appliquer toutes les décisions prises par les organes sociaux."

> *"The associated Societies may depart from the standard contracts established by the BIEM to the extent that they are subject to legal provisions of a compulsory character. These changes must be brought to the knowledge of the Management Committee..."*[21]

2.2.11 This is the case in Ireland under the Copyright Act 1963 if the parties cannot agree on a tariff. It was also the case in the UK under the 1965 Copyright Act and, although the compulsory scheme was abolished by the Copyright, Designs and Patents Act 1988, the rate in the UK is still subject to regulation by the Copyright Tribunal. This is why the BIEM member operating in the UK, the Mechanical Copyright Protection Society Limited and the BIEM member in Ireland, the Mechanical Copyright Protection Society Ireland Limited (together "MCPS"), have never operated under the terms of standard contracts established by BIEM.

2.2.12 Article 13 of the BIEM Statutes

2.2.13 Article 13 of the BIEM Statutes reads:

> *"Any associated Society which by its actions injures the moral or material interests of BIEM, deliberately violates all or part of the present statutes or refuses to carry out decisions made in pursuance of them, may be expelled from BIEM by a decision of the General Assembly on a recommendation of the Management Committee, after having been heard by the General Assembly if it so requests.*[22]

2.2.14 It follows that BIEM members are obliged to conform to decisions made by BIEM and, since BIEM is mandated to negotiate standard contracts on their behalf, they must comply with the rate and other terms set by such contracts in all licensing deals they enter.

2.2.15 As already explained in Section 1 above, Universal does not object in principle to the existence of the Standard Contract. However, where the arrangements established by the Standard Contract contain contractual provisions which have the object and/or effect of preventing, restricting or

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21 *"Les Sociétés associées peuvent déroger aux contrats types établis par le BIEM pour autant qu'elles soient soumises a des dispositions législatives de caractère impératif. Ces dérogations doivent être portées a Ia connaissance du Comité de Direction dans les soixante fours suivant leur entrée en vigueur."*

22 *"Peut être exclue du BIEM par décision de l'Assemblée Générale, sur proposition du Comité do Direction, Ia Société associée ou Ia Société adhérente qui, par ses agissements, nuirait aux intérêts moraux ou maté ne/s du BIEM, violerait délibérément tout ou partie des présents Statuts ou refuserait d'exécuter /es décisions prises par application de ceux-ci."*

distorting competition and thereby to operate in practice to deliver or preserve an anti-competitive outcome, while foreclosing all possibility of alternative choices for the licensing of phonomechanical rights throughout the EU, any pro-competitive rationale for their existence must necessarily fall away.

3 RELEVANT MARKET

3.1 Product market

3.1.1 The relevant market is that for the licensing of phonomechanical rights in all sound bearing copies of recordings of musical works (the "Relevant Market").

3.1.2 The basis for this definition is the fact that in order to produce sound recordings for sale to the public, record companies, as consumers, must obtain the mechanical reproduction right. There is no alternative. Consistent with the "SSNIP" test as described at paragraph 17 of the Commission's Notice on Market Definition,[23] in the event of an increase in the price of mechanical royalty rates, Universal and other users would not be able to switch to another product. There are no other substitutes for the right, or other suppliers of the same. Indeed, from both a demand and supply substitution perspective, BIEM alone holds the requisite rights and controls the terms of access to them.

3.2 Geographic market

3.2.1 As the Commission knows, the licensing of mechanical rights in the EEA is carried out on a collective basis by national collecting societies at the national level (because systems of copyright legislation are for the most part laid down by EEA States and administration of such national copyright in protected works is conducted by each national collecting society) and, through reciprocal representation agreements between the various collecting societies, at an international level also.

3.2.2 The relevant geographic market is defined by the area in which BIEM is able to establish certain standard licensing terms, on the basis that the very fact of setting standard terms makes the

[23] 97/C 372/03.

conditions of competition "sufficiently homogeneous" to constitute a single geographic market.[24] The relevant geographic market therefore is the "BIEM Area", i.e. an area comprising the territories of all BIEM's members within the EEA, (which as mentioned above, does not include the United Kingdom and Eire).

4 THE PRACTICAL OPERATION AND BACKGROUND OF EU COLLECTING SOCIETIES AND THE STANDARD AGREEMENT

The Collecting Societies

4.1 As the Commission is aware, collecting societies exist to manage the copyrights in the original works of their members who, in the sphere of musical works, will be authors, composers and music publishers. Whilst Universal does not wish to burden the Commission with a lengthy summary of the manner in which collecting societies operate, since this is an industry with which the Commission has a considerable degree of familiarity, it nonetheless considers that the following short analysis may assist the Commission in its assessment of this Complaint.

4.2 Under all Continental collecting societies' statutes, members of a society (whether composers, authors or the music publishers who represent them) are generally required to transfer, on an exclusive basis and for all countries, the right to authorise or prohibit mechanical reproduction of the rights in their sound recordings. A monopoly situation therefore exists in favour of each society in respect of the country in which it operates.

4.3 Each society requires the co-operation of other societies in order to confer licences for the world-wide repertoire. This co-operation is embodied in the reciprocal representation agreements under which the societies pass rights to each other. By virtue of these reciprocal agreements each of the societies undertakes to manage the rights attached to the repertoire of each foreign society within its own sphere of operations (normally its national territory) on a reciprocal basis. To this end, each society agrees to apply, in relation to the collection of royalties due in respect of the foreign repertoire, the same terms and conditions that it applies to its own repertoire. By virtue of both agreements with their own members and reciprocal agreements with other societies throughout the world, societies control, in their respective sphere of operation, copyrights in practically the entire world repertoire of protected musical works. (Reciprocal representation agreements are the subject

[24] See for example, paragraph 29 of the Commission's Notice on Market Definition.

of a number of provisions in the BIEM Statutes - please refer to the Statutes attached at Annex 5 for further details). This system enables central licensing agreements to be concluded whereby users can go to a single collecting society to acquire a central licence for repertoire[25]. Universal has entered in to such a central licensing agreement with the Mechanical Copyright Protection Society ("MCPS") in the United Kingdom (on the basis that the MCPS requires that the BIEM Standard Rate is charged to Universal in respect of all sales in the BIEM Area).

4.4 In 2000, it is estimated that record companies paid €593 million in the BIEM Area for the licensing of mechanical rights.

Background To The BIEM-IFPI Standard Contract

4.5 In Section 5 of this Complaint, Universal describes the specific provisions of the Standard Contract which infringe the EU competition rules. By way of background to that analysis, a general understanding of the Standard Contract is required.

4.6 The Standard Contract is concluded between BIEM and IFPI. It is a model licensing agreement establishing the terms on which individual Relevant BIEM members will contract with individual IFPI members. That contract fixes the Standard Rate referred to above and other terms which the Relevant BIEM Members are obliged to apply. Such a contract has operated since 1930. The last version was adopted in 1975; it has since been amended seven times, and expired on 30 June 2000. It is understood that the 1975 version of the Standard Contract was notified to the Commission on 14 January 1976; in 1993, the Commission initiated formal proceedings based on its objections to certain clauses of the Standard Contract. Amendments to the Standard Contract made in 1988, 1989 and 1992 were notified by BIEM to DG Comp (then DGIV) on 29 August 1996. Further amendments to the Standard Contract were made in 1997 and were subsequently notified

to DG Comp. Further, Universal understands that following notification, a comfort letter was granted

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25 That this is a laudable objective was recognised by the European Commission in its 1985 Press Release in relation to the activities of the German collecting society, GEMA, where it clearly stated that: *"A separate* requirement to pay royalties to the national copyright protection society having "jurisdiction" over the p/ace of manufacture according to the rates applicable there would in practice mean the re-erection of national barriers by contractual means between the member state?. (paragraph 3 of the Press Release of 6 February 1985; 2 CMLR.

in respect of the BIEM Statutes, although, as mentioned above, Universal believes that this comfort letter was issued by the Commission without full knowledge of all the facts concerning the practical operation of certain provisions of those Statutes in the context of the Standard Contract.

4.7 Article V(4) Annex No. 5 of the Standard Contract fixes the Standard Rate. The rate is based on a rate which was first fixed in 1930 and since has become set in stone. Until 1985, the rate was charged on the basis of retail prices[26]. Since 1985, it has been charged on the record companies' published price for sales to dealers ("PPD"). The gross rate was fixed at 11% of PPD. The 11% rate was arrived at in 1985 by converting the rate of 8% then charged on retail price to a PPD base. This was done by applying an increase or mark-up of 37.5% on the 8% rate to represent the average mark-up (on PPD) by retailers (less taxes and duties). That 37.5% was the agreed average retail mark-up in Continental Europe at the beginning of the 1980's. This figure was established on the basis of the mark-ups on PPD which were, at that time, being negotiated on a national basis between IFPI members and individual BIEM members, in order to arrive at the retail prices on which the rate was then calculated. As demonstrated in the paragraphs below, in the intervening period mark-ups have diminished significantly. The 11% rate is, in the most recently expired version of the Standard Contract, now subject to an allowance for discounts granted to dealers by record companies at a flat rate of 9% and a deduction for packaging costs set at a flat rate of 10%, yielding a net rate of 9.009% of PPD. With minimum royalties and maximum tracks, this amounts to a total net rate of 9.2% of PPD.

4.8 As mentioned above, the latest version of the BIEM/IFPI agreement expired at the end of June 2000. BIEM required that until any new deal was finalised, the record companies should continue to account on the pre-existing basis[27]. Initially, discussions on a renewal focused on the possibility of introducing an actual realised price reporting system, (i.e. on an item by item basis where actual realised price is equivalent to PPD less all discounts[28] (considered in more detail at paragraph

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26 In 1930, the Standard Contract set the royalty rate at 3.75% of the retail selling price per side, (7.5% for two sides). This was increased by the 1947 Standard Contract which set the rate at 4% of the retail selling price per side, (8% for two sides).

27 A copy of a letter from Cees Vervoord of BIEM to the Jason Berman of the IFPI dated 27 June 2000, which sets out these terms, is attached at Annex 7 to this Complaint.

28 The discounts discussed were as follows: (a) File discounts (customer-related discounts, negotiated yearly, applicable to all purchases); (b) Early payment discounts; (c) volume discounts (given to a particular customer

4.9)). As already noted, the Standard Rate originates from 1985, when the then retail rate of 8% was converted into a PPD rate of 11%. This was by reference to the then prevailing average retail mark-up of 37.5%. The current average retail mark-up is estimated by Universal to be in the region of 14.1%,(see Annex 8). Indeed, if the current gross rate of 11% was revised in line with the retail mark-up actually estimated to exist by Universal, (i.e. 14.1%), the net rate would be reduced to approximately 7.474%, representing a considerable saving in royalty, to Universal, in the region of [*confidential business secret]* million per annum (and a saving of [*confidential business secret]* million per annum to the industry[29]. BIEM is therefore able to inflate the Standard Rate and produce an anti-competitive outcome by taking no account of the changes in commercial usage that have taken place since the Standard Rate was originally agreed in 1985.

4.9 Similarly, as the Commission knows, discounts off the PPD represent a fundamental dynamic in the competitive process for the sale of sound carriers between record companies, wholesalers and retailers[30]. The greater the discount of PPD applied by record companies, the lower the net price; unless full account is taken of these discounts in calculation of the BIEM royalty, a higher actual level of the royalty is charged by BIEM, since the BIEM rate is based on PPD less the fixed discount. Average discounts currently amount to approximately 16.5% of the product price, (according to industry and Universal own estimates whereas the terms of the Standard Contract only recognise a flat rate of 9%. (Universal would point out that according to its estimates, a reduction of 0.1 percentage points in the net BIEM rate (9.009%) represents an estimated saving to record companies of approximatively €7 million per annum in the BIEM Area[31]. This would equate to an approximate saving to Universal of €[*confidential business secret]* million per annum in the BIEM Area). A change to an actual realised price model, which took account of all discounts at 16.5% (and not accounting for the actual mark-up (of 14.1%) discussed above) would result in a rate of 8.267%

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once pre-determined value of volume of purchases is achieved e.g. year-end bonuses, incentives); (d) campaign discounts (given to help promote sales of a particular release, artist or genre); (e) advertising discounts (given in recognition of a retailer's campaign to promote a particular product); (f) other. On occasion, Universal also gives away free product to its customers in lieu of discounts; therefore free product is reflected in Universal's discount figures.

29 This is calculated on the basis that discounts stays the same as currently accounted for under the terms of the Standard Contract.

30 See for example, the findings of the UK Monopolies and Mergers Commission ('MMC") (now referred to as the Competition Commission following the introduction of the Competition Act 1998) in its report following investigation into the Supply of Recorded Music (Cm 2599), in particular at paragraphs 1.13,2.116 and 5.54.

31 Based on the €593 million cost to the industry in the BIEM Area, as discussed at paragraph 1.11

representing a reduction in cost to the industry of approximately €49 million and to Universal of approximately €[confidential business secret][32]. In the discussions with BIEM, IFPI argued that BIEM must take into account in the Standard Contract current commercial usage, including the level of discounts offered to customers. Put simply, record companies should not pay royalties on money they do not receive. In relying upon a discount structure which never reflected reality, BIEM was taking into account matters which had no legitimate connection with the present day subject matter of the contract. Independent experts, PricewaterhouseCoopers, were jointly instructed by BIEM and the IFPI, at BIEM's suggestion, to determine the best way of dealing with off-invoice discounts, an important element in the actual realised price scheme proposed by the IFPI.[33] PWC prepared a significant proportion of a report resulting from this study but at the last minute, BIEM refused to consider, even in principle, the idea of an actual realised price. The report was therefore never finalised. BIEM rejected a move to an actual realised price scheme on the claimed grounds that it was too complicated; Universal would disagree with this claim and instead considers that the real grounds for BIEM's objection stemmed from the fact that such a system would have required BIEM to fairly recognise the full discounts currently granted by record companies to their customers[34]. BIEM has refused to take any realistic account of the significant increase in discounts since 1990, if not before. Indeed, since 1985, if not before, discounts have consistently exceeded the discount allowance of 9% provided for in the (now expired) Standard

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above.

[32] If BOTH the actual mark-up (14.1%) and actual discounts (16.5%) figures were taken into account - as Universal submits they should be, Universal calculates that the net rate should reduce from 9.009% to **6.858%,** resulting in a saving to the industry of approximately €142 million per annum and to Universal of approximately € *[confidential business secret]* million per annum. See the Summary Sheet at Annex 9 for further details of this calculation.

[33] Off-invoice discounts are discounts which are generally granted by record companies to customers by way of a lump sum, retroactively, usually in recognition of large volume orders during the course of the past year. Because a system of actual realised price would operate to include on-invoice discounts, i.e. discounts accounted for the time the invoice is sent, these off-invoice amounts still need to be factored into the calculation to ensure that the actual realised price is accurate..

[34] Correspondence between BIEM and IFPI representatives concerned the actual realised price work undertaken is annexed to this Complaint at Annex 10.

Contract[35]. The proposal to move towards actual realised price, (initially made by IFPI in January 1998) constituted an effort by IFPI to achieve more accurate reporting and to bring the royalty rate back into line with discounts actually awarded, rather than maintain the outdated and arbitrary figure selected by BIEM in 1997.

4.10 However, in an attempt to meet the practical difficulties claimed by BIEM, IFPI suggested that the royalty rate should move to one of average realised price. As with the study on the outcome of calculating royalties based on actual realised price, IFPI had also undertaken considerable work to demonstrate to BIEM that it is also possible to calculate the average net price received by users for sound carriers. IFPI analysis at the time showed that the average realised price amounts to a discount off PPD of approximately 16.5%, compared to the BIEM permitted discount of 9%. BIEM however rejected this proposal also and indicated to the IFPI that they were not prepared to accept any change to the Standard Contract that would negatively impact their revenues[36].

4.11 Whilst discussion continued for some time on other areas of disagreement (such as reduced royalty rates for Eastern Europe and Latin America) BIEM refused to enter into any reasonable negotiations with IFPI on the main terms of the agreement. At the same time, BIEM intervened and frustrated attempts by the national entities to negotiate at the local level on the basis that only BIEM is allowed to undertake such negotiations. This is evidenced in the correspondence between IFPI and its various members provided at Annex 11, which illustrates the difficulties that national entities have encountered when trying to negotiate outside the terms of the BIEM Standard Contract.

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35 Prior to 1985, there was no discount allowance. The 1985 contract introduced this "adjustment ... when warranted by invoiced discounts which are usually applied" specifying that "the percentage will be determined by agreement between the society and the National Group of the IFPI". For the first semester of 1988, a ceiling of 4% was introduced for this adjustment and from the second semester of 1988, it became a flat rate deduction of 4%. This deduction was increased to 6% in 1992 and 9% in 1997. Throughout this entire period, such allowance has never reflected market reality.

36 Further evidence of BIEM's refusal to consider revision of the terms of the Standard Contract, in particular, the basis on which the royalty is calculated, is demonstrated by discussions taking place on 3 December 1999, as reported in the Japanese collecting society's publication JASRAC Now, in January 2000 — a copy of which article, together with an unofficial translation appear at Annex 15. During the course of the discussions, it is reported that BIEM considered countermeasures towards negotiations on revising the Standard Contract with the IFPI and confirmed that it did not intend to deviate from the current method of calculating royalties, i.e. PPD and a royalty rate of 9.009%. Interestingly, BIEM had clearly reached this decision at the same time that it had agreed with the IFPI that PWC should conduct the survey work into actual realised price. In Universal's view, this clearly demonstrates that BIEM in actual fact, had no intention of negotiating an alternative model for royalty payments.

Universal refers by way of example, to the correspondence between Mr Eduard Simoes, Director General of the Portuguese recording companies association, AFP and Luiz Francisco Rebello, Managing Director of the Portuguese Authors' Society, SPA:

> *"I refer to your letter .. .proposing to open negotiations on the licensing of mechanical rights of the works included in SPA'S repertoire.*
>
> *"According to the instructions received from BIEM, and since the mentioned repertoire includes not only works by National authors but by authors represented by foreign societies as well, these negotiations should be done with either the presence of the Chairman or the Secretary General of BIEM."*

4.12 A further example of difficulties encountered in Poland also appears in this correspondence. In a letter dated 19 February 2001, Grzegorz Burakiewicz, supervisor of the mechanical rights department at ZAIKS, the Polish Collecting Society writes:

> *"We have presented BIEM with your proposals concerning the amendments to the standard ZAIKS-ZPA V agreement. In its reply, BIEM stated that it did not allow for a possibility of national organisations departing from the so-far binding principles determined in the standard BIEM-IFPI agreement...."*

4.13 The underlying policy pursued by BIEM to the adoption of any possibility of national negotiation producing a competitive outcome, was well illustrated by the intervention of Mr Tournier, during the previous round of BIEM/IFPI negotiations prior to the settlement of the 1997 contract. Mr Tournier, then president of BIEM, wrote in May 1997 that:

> *"BIEM alone is the competitive body to fix the terms of authorisation for reproduction of sound recordings of our societies repertoire. It is therefore out of the question that there be any place for national agreements."*

4.14 Further evidence of the refusal of BIEM and the Relevant BIEM Members to discuss the level of the Standard Rate with record companies and other users is also clearly demonstrated in the more recent speech given by the President and Chief Executive Officer of GEMA on 27 June 2001, where he emphatically stated[37]:

> *"The standard contract between the collecting societies on joined together in BIEM and the record industry in IFPI International expired on 30 June 2000. So far, the international IFPI could not see its way to renewing this contract. I deliberately use the term "renewal" as we in BIEM — spearheaded by GEMA — are firmly convinced that a reduction of the tariff is out of the question and that the currently valid tariff of 9.009% of the PPD ... is commensurate and that there is no obvious reason to deviate downwards from this tariff. This will not happen as long as GEMA is involved, even if it means that there might be a longer period of time with no tariff agreement ahead of us.*

[37] See footnote 15 above for an indication of where this speech may be found.

4.15 Crucially, this intervention has continued despite the expiry of the Standard Contract. BIEM has continued to insist on the fixing of royalty rates in accordance with the terms of the expired Standard Contract and has further insisted that the provisions of Article 7 continue to apply, thereby preventing its members from entering into national negotiations with record companies and users trying hard to conduct business on a more equitable scale. The consequence of this policy, in particular, its prevention of negotiation at a national level, is elaborated further in Section 5 below, when considering the practical operation of Article 7 of the BIEM Statutes within the context of Articles 81 and 82.

4.16 Finally, before turning to the substantive legal analysis under Articles 81 and 82, it is worth recalling the overall disparity in bargaining power of BIEM and the record company users such as Universal, to whom it is seeking to dictate the terms of the Standard Contract. Unlike BIEM and its members (who are insulated from competitive forces at all levels of the market), Universal and other record company members of IFPI compete vigorously in the market place, both in marketing their sound recordings, in their dealings with wholesalers and retailers as regards price and other terms and conditions of sale and in searching for, signing and developing both new and established artists.

4.17 This is in stark contrast to the quiet life of the monopoly collecting societies who are shielded from the forces of competition. This was recognised in terms by the UK Copyright Tribunal in the proceedings between the British Phonographic Industry ("BPI") and Mechanical Copyright Protection Society ("MCPS") for settlement of the UK Mechanical rate when it concluded that "whilst other record company costs (labour, artists' royalties, and so on) are subject to competitive forces, the recording licence royalty is not." Since BIEM and its members are monopolies and "partenaires obligatoires" who will naturally attempt to fix a monopoly price, the economic forces at work are not competitive forces (see BPI v MCPS[38]). It is to be recalled that unlike the position in the UK, there is no copyright jurisdiction which can adjudicate at an EU or EEA level to settle licensing terms. In the absence of regulatory intervention, it is to be expected that the BIEM rate will naturally settle at a monopoly rate because this is the rational profit-maximising outcome for the

monopoly societies. Accordingly particular vigilance is required in order to ensure that the

[38] EMLR 83.

competition rules are not violated by operation of anti-competitive contractual terms leading to an unfair/excessive rate.

5 APPLICATION OF ARTICLES 81 & 82

5.1 In terms of the application of Article 81(1) of the EC Treaty to the Standard Contracts, the following five legal propositions are, it is submitted, uncontroversial.

(i) **The Standard Contract is an agreement between undertakings**. The Standard Contract sets out the terms which all Relevant BIEM Members agree to apply in their dealings with IFPI members. That agreement, as noted, is contained in Article 7 of the BIEM Statutes. Alternatively, BIEM's decision to adopt the Standard Contract, in the context of its authority under Article 7 of the BIEM Statutes, constitutes a decision of an association of undertakings. Article 81(1) specifically provides that all decisions by associations of undertakings constitute agreements between the members of those associations and thus BIEM decisions and recommendations, particularly binding decisions to impose a standard rate or other standard terms, in themselves are susceptible to review under Article 81(1).

(ii) **The Standard Contract has an effect on inter-state trade**. Although the agreement to apply standard licensing terms in an agreement between licensing bodies which operate principally on a national basis, the fact that licensing terms are established for all Continental EU countries and the fact that the agreement is between national monopolies which cross-license each other on standard terms through the reciprocal agreements is sufficient, in Universal's view, for the agreement to be considered to effect inter-state trade.

(iii) **Monopolies of collecting societies**. Within their own territory, each national collecting society is in a dominant position by virtue of its de facto monopoly as the only undertaking managing mechanical rights and controlling the repertoire both of its members' musical works, and through reciprocal licence agreements with other BIEM national collecting

society members, works managed on their members' behalf;[39] in many cases, such as in Germany, these national monopolies are reinforced by statute. Authors and composers, at any rate in Continental Europe, have no choice but to deal through a collecting society. As the Commission may recall, in BPI v MCPS (No 2) evidence was cited that the Relevant BIEM Members had close to 100% coverage of the musical works actively exploited in their territories.[40] Other than a relatively small volume discount for costs savings offered by most collecting societies, which appears to be fixed by agreement between the collecting societies at 2.5%, for users such as Universal, who conclude central licensing deals, there is no price or non-price competition in the licensing of mechanical rights throughout the BIEM Territory. This is therefore a monopoly situation resulting in a monopoly price.

(iv) **Collective dominance of collecting societies**. Clearly, in the light of what is said in (iii) above, the dismantling of BIEM would not resolve the problem raised in this Complaint given the fact that the national societies would remain dominant in their own territories. Equally, the strong economic links between the National Collecting Societies, which exist by virtue of the conclusion of reciprocal arrangements and by the co-ordination of their actions through the auspices of BIEM, justify their treatment as jointly dominant. In the present case, it is clear that the Relevant BIEM Members operate as a single entity in negotiating licensing terms. As already noted, Article 7 of the BIEM Statutes in practice has the effect that members are legally obliged to act together and that their behaviour is co-ordinated and as such the collective dominance held by the Relevant BIEM Members is a very clear example of the concept of collective dominance defined by the ECJ.

There are a number of clear, established authorities supporting Universal's position that, in these circumstances, the Relevant BIEM Members are collectively dominant. For

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39 See for example, Case 127/73 BRT v Sabam and Fonior ECR 313; Case 395/87 Toumier~1 989] ECR 2521.

40 The legal position (which has not changed and is still reflective to today's status quo) was well explained by Advocate-General Mayras in Case 127/73 BRT v SABAM (ELR 313) in relation to SABAM, the Belgian collecting society: "Moreover, the Brussels court used the expression 'de facto monopoly' to describe SABAM's position in Belgium. It is not disputed that this association has, since 1940, been the only undertaking in Belgium having the task of exploiting copyrights, in particular in the field of musical compositions. As is the position with GEMA in the Federal Republic of Germany, it has no competitor..."

example, in a long line of cases concerning Shipping Liner Conferences,[41] the Commission has accepted that where:

(a) parties are linked (often structurally by means of an agreement or decision of a governing or representative body) in a manner which results in their adopting the same conduct on the market and they present themselves, and/or act together, on the market as a united, collective entity;[42] and that

(b) moreover, they are the only bodies with the rights to manage or organise the rights in question,[43]

this can lead to those undertakings being collectively dominant in the relevant market in which they operate.

Similar findings of collective dominance (and resulting lack of effective competition) between a number of entities co-operating or working together on a horizontal level in the same relevant market have been made in a number of other markets, for example, the agricultural-scientific field and telecommunications field[44]. Universal considers that each

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41 See for example Compagnie Maritime Beige Transport SA V Commission, (~1996] ECR II 1201); French West-African Shipowners Committees (Case IV/32.450; Danish Shipowners Association case (Case 93/83/EEC, 5 CMLR 198) and the TACA case (Case IV/35.134 16 September 1998, OJ L095).

42 See for example, Compagnie Maritime Beige Transport SA V Commission, (~1996] ECR II 1201 at paragraphs 36 and 62),where the CFI upheld the Commission's finding of collective dominance stating that:
"In order for such collectively dominant position to exist, the undertakings in question must be linked in such a way that they adopt the same conduct on the market ..

43 See for example, French West-African Shipowners Committees (Case IV/32.450; 5 CMLR 446 at paragraphs 56 and 57) where the European Commission found a group of French Shipping Lines and the national lines of 11 West African countries, which had formed committees to operate a cargo-sharing system on the bilateral routes between France and those countries, to be collectively dominant. The Commission reasoned that the committees "present~ed] a united front to shippers at their regular consultations, concerning, in particular, the fixing of freight rates.." This led the Commission to state that "... the market position of the shipping companies that are members of the committees must be assessed collectively..
The Commission also considered pertinent the fact that the committees were the only bodies in France with the right to manage the trade and concluded that, "the setting up of shipowners' committees by a group of shipowners covering virtually the entire market resulted in the creation of a collective dominant position to their advantage See also the Danish Shipowners Association case (Case 93/83/EEC, 5 CMLR 198) and the TACA case (Case lV/35.134 16 September 1998, OJ L095, p1 at para 13) where similar collective dominance findings were made in respect of shipping liner conferences or committees.

44 In this regard, Universal refers the Commission to an analogous case, of particular relevance to the Complaint: Case C-323/93 Centre d'lnsemination de la Crespelle v Coopérative de la Mayenne, where the Court of Justice, in considering the local monopolies granted under French law to bovine insemination centres,

of these authorities demonstrate that collective dominance can exist where a number of independent entities are tied together by economic or structural links. It is the tying together of these entities by the economic or structural links rather than the number of such entities which is the key issue in the Italian Fiat Glass case.[45] It necessarily follows that the Relevant BIEM Members are collectively dominant given that they: (a) clearly present a "united front" to users through BIEM, as their representative body; (b) effectively hold all the rights in the relevant market and act as the only real "port of call" for users, without being subject to any competition; and (c) their reciprocal relationships and industry agreements bind them together, structurally, in similar fashion to those arrangements previously considered by the Commission. In view of these considerations, Universal considers that the Relevant BIEM Members are unquestionably collectively dominant on the relevant market.

(v) **BIEM members are able to act independently of competitors and customers**. By virtue of Article 7 of the BIEM Statutes the BIEM member in each Member State is a *"partenaire obligatoire"* (an unavoidable trading partner) for record companies who require mechanical reproduction rights in that state in order to carry on their businesses and as such is able to act independently of its customers. Equally, the Relevant BIEM Members are able to act independently of customers (including the record industry) quite simply because they hold all the rights.

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appeared to have treated the centres as jointly holding a dominant position by virtue of the rights granted to each of them over a contiguous series of areas. Paragraph 17 of the Court's judgment provides that: "...by making the operation of the insemination centres subject to authorisation and providing that each centre should have the exclusive right to seive a defined area, the national legislation granted those centres exclusive rights. By thus establishing, in favour of those undertakings, a contiguous series of monopolies, territorially limited but together covering the entire territory of a member state, those national provisions create a dominant position within the meaning of Article [82]..."

[45] Joined Cases T-68/89, 1-77/89 and 1-78/89, Società Italiana Vetro SpA, Fabbrica Pisana SpA and PPG Vemante Pennitalia SpA v. Commission ECR 11-1403, where at paragraph 358, the CFI held that: "There is nothing, in principle, to prevent two or more independent economic entities from being, on a specific market, united by such economic links that, by virtue of that fact, together they hold a dominant position vis-à-vis the other operators on the same market."

5.2 Against the background of these five legal principles, we now turn to consider those specific aspects of the Standard Contract which Universal submits infringe Article 81(1) and/or Article 82, namely, as outlined earlier, the provisions relating to:

(i) the Standard Rate, in particular the mark-up and discount components thereof (and the related impact of Article 7 of the BIEM Statutes);

(ii) minimum royalties; and

(iii) maximum tracks/playing time.

THE STANDARD RATE

Article 81(1)

5.3 The operation of the current Standard Rate amounts to a horizontal agreement by the Relevant BIEM Members in relation to the rates they will charge record producers. These rates are obligatory for the Relevant BIEM Members by virtue of Article 7 BIEM Statutes, as a result of which each Relevant BIEM Member has in fact undertaken not to supply services at a lower price than that set by BIEM. Accordingly, the agreement to operate this current level of Standard Rate must be viewed as a form of collective price maintenance which interferes in the freedom and ability of independent undertakings to set prices and as such is a particularly serious breach of Article 81(1) since it clearly does not qualify for exemption by reference to the criteria of Article 81(3). In this regard, the legal analysis is analogous to that adopted by the Commission in Case Coflp/D1129.373 Visa International, where the Commission took the view that the multilateral interchange fee operating between Visa issuing banks constituted a collective price fixing agreement determining a mandatory charge that the issuing banks had to charge customers. As in the Visa case, the BIEM Standard Rate restricts the freedom of action of individual undertakings and imposes a common price throughout the BIEM Area. Whilst, as Universal acknowledges, such a collective arrangement as operated by BIEM, despite falling within Article 81(1), could be capable of exemption, (for reasons including the facilitation and promotion of technical and economic progress and consumer benefits arising out of more efficient management and ease of obtaining access to rights), for the reasons set out in this Complaint, the current terms of the Standard Contract in general and the Standard Rate in particular, in their present form, prove unfair, restrictive and disproportionate and any potential benefits are lost; it follows that none of the terms

which are the subject of this Complaint, including those relating to the level of the Standard Rate, are indispensable to achieving the beneficial objectives that the arrangement could potentially achieve[46]. Indeed, Universal submits that some of the key provisions in the Standard Contract, as currently operated, purely protect the interests of the collecting societies, to the significant detriment of users such as the record companies (see further paragraph 5.8 below).

5.4 This analysis is consistent with the "rule of reason" approach adopted by the Commission and the Court of Justice to membership organisations. It is well-established that Article 81(1) applies to such arrangements where the rules of the membership organisation are not *"restricted to what is necessary to ensure that the [agreement] functions property"*;.[47] A similar approach has been adopted by the Commission to multilateral pricing arrangements.[48]

5.5 The starting point in this assessment is that, consistent with Article 81(1)(e)[49], a reasonable royalty rate must be calculated by reference to current commercial usage for the exploitation of the relevant right. Any assessment which fails to take into account actual market realities, such as the current high level of discounts which record companies have to give to retailers is, by its very

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46 Universal would reiterate that it is not the nature of the collective management arrangement to which it objects, but the anti-competitive, unfair manner in which it is operated that gives rise to Universal's concerns.

47 See Case C-250/92 Gottrup Klim v Dansk Landbrugs Grovvareselskab, (~1994] ECR I 5641), judgment of the Court of First Instance at paragraphs 2, 4 and 35. The Court of Justice also ruled that: "the compatibility of the statutes of such an association with the Community rules on competition *cannot be assessed in the abstract. It will depend on the particular clauses in the statutes and the* economic conditions prevailing *on the markets concerned*' (paragraph 31).

48 See for example, the Commission's Notice on the Application of the EC Competition Rules to Cross-Border Credit Transfers, see in particular, paragraphs 2, 5 and 40. At paragraph 40, the Commission advises that:
"a multilateral interchange fee agreement is a restriction of competition falling under Article because it substantially *restricts the freedom of banks individually to decide their own pricing policies*. The restriction is likely also to have the effect of distorting the behaviour of banks vis-à-vis their customers (see paragraph 40 of the Notice].... Where agreements on multilateral interchange fees fall within Article , it is *only where they are* shown to be actually necessary for the successful implementation of certain forms of co-operation that they may be capable of obtaining an exemption under Article (81(3)]. ... Where however, banks introduce multilateral interchange fee arrangements, the Commission, (in applying the criteria set out in Article (81(3)] for obtaining an exemption) will examine the economic benefit which these arrangements seek to achieve and consider whether consumers (including both those who are customers and those who are not) will receive a fair share of the benefit *and whether the particular interchange fee arrangements are actually necessary as a means to achieve that benefit..."* See also Uniform Eurocheques, 3 CMLR 434, the Commission's decision in P&I Clubs, (Cases No. lV/D-1/1/30.373 and No! lV/D-1/37.143, OJ L125 19/05/1 999, pp 12-31 and Nuovo CEGAM, 2 CMLR 484 for further examples demonstrating this same reasoning.

49 Article 81(1) prohibits inter alia measures which "(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts..."

nature, likely to produce an arbitrary result.[50] As matters currently stand, BIEM is making the conclusion of the Standard Contract subject to pre-conditions (ie acceptance of mark-ups and discount structure which are out of date) which, according to current commercial usage, have no legitimate connection with the contract. Universal would emphasise that in saying this, it is not advocating that PPD as a basis for calculating the royalty is inherently unfair or anti-competitive and therefore, some alternative basis should be used. Rather, it is Universal's submission that in assessing the impact of the contractual provisions concerned and making a determination whether they may distort competition, it is necessary to take into account all those current market considerations that a willing licensor and willing licensee would take into account, each bargaining on equal terms to arrive at a fair and proportionate royalty. A fair and efficient division of the returns to the various holders of intellectual property rights should then be assessed, based on the relative effort and risk borne by each party. It is clear that if one major element of the calculation, such as the general level of discounts, changes materially, the optimum royalty rate will also change materially. Even if, quod non, the rate set was appropriate in 1985, it is clearly not appropriate now.

5.6 The current royalty demanded by BIEM is a monopoly rate (and, therefore, by its nature does not represent what a willing licensor and willing licensee would agree) which cannot be justified under the EC competition rules unless it bears a reasonable relationship to current economic market conditions. As such, it maintains prices at levels that are higher than would otherwise be applicable (indeed, as mentioned, the rate is the highest in the world — see Annex 3) and limits the production and sale of goods in a manner which cannot be justified under either Articles 81 or 82. Universalwould note within this context that the out-dated and arbitrary nature of the current level of the Standard Rate can be compared to the situation prevailing as regards commission rates chargedby collecting societies to their own members. It will be recalled that the Cannes Agreement, concluded on 13 November 1997 and which, so far as Universal is aware, is still in force[51], resulted in a dramatic reduction in the collecting societies' commission rates. These reductions in commission rates demonstrate that the societies are capable of reducing their commission rates when it is in their interests to do so, i.e. in response to pressure from their own members.

However, such reductions have not been passed on to users, i.e. customers of the societies, who

[50] See IFPI's press releases dated 16 and 24 April respectively at Annex 13 and ABN-AMRO's review of the Global Music industry, dated 24 January 2002, at Annex 14.

should equally be entitled to benefit from such savings, reflected as they could be, in the levels of royalty payments required of such customers.

5.7 There is no doubt that the financial and other costs to record producers Sand ultimately to consumers arising from the imposition of a monopoly rate, are significant. Record companies bear all the risks in making a product a commercial success[52] and the publishers and collecting societies are not exposed to similar risks in this regard, getting paid as they do, from the first record sold. Indeed, the relative efforts of (and risks taken by) licensor and licensee were regarded as of integral importance by the Copyright Tribunal in BPI v MCPS:

> *"it is normally the case in the licensing of an intellectual property right that regard is had to the relative functions of licensor and licensee in bringing the product the subject of the right to market. If it is the licensor who does all the work and takes most of the risk and the licensee merely rides on that work, then this is a factor pointing to a higher royalty. But if it is the licensee who does most of the work then he would normally expect to pay less by way of royalty."*

5.8 The current terms for the licensing of mechanical royalties described in this complaint only reinforce the disproportionality in the balance in costs and risks between record producers and publishers. While it is acknowledged that composers expend creative effort in writing songs, it is submitted that record companies expend much greater sums in bringing records to market, including finding and signing artists, artists' advances, recording costs, marketing, promotion, sales and distribution.

5.9 Universal considers that alongside the current Standard Rate and its method of calculation, Article 7 of the BIEM Statutes serves to exacerbate infringement of Article 81(1) and cannot be considered as indispensable to achievement of any of the pro-competitive objectives which would fall for consideration under Article 81(3).

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51 And so far as Universal is aware, this Agreement continues to prohibit direct distribution (described in 5.19 below).

52 It should not be overlooked that only 1 in 10 releases actually achieve commercial success. The costs associated with investment in the remaining 9 releases represent sunk costs that often cannot be recouped in any form.

Mark-up

5.10 Universal considers that it is entirely arbitrary and unjustified for BIEM to continue to require that a mark-up applying in 1985 should continue to apply despite direct, uncontradicted evidence that the level of mark-up has since decreased to such a significant extent. Indeed, such a requirement makes the terms on which Universal and other record companies license rights from BIEM's members, subject to obligations which have no connection with the subject of such contracts or current commercial usage. This is symptomatic of the fact that the Standard Rate is fundamentally inappropriate in the current market.

5.11 Such mark-up may have been relevant in 1985 but it clearly no longer reflects market realities, and should not continue to be applied. These "substantial changes in the market', including the fact that "prices and margins have undoubtedly been seriously affected' were recognised in terms by the Swiss Competition Authority (Surveillance des Prix) in its opinion (of 15 October 1997) to the Swiss Arbitration Commission on SUISA's request for a prolongation of the existing tariff according to the terms of the Standard Contract ("the Swiss Competition Authority Opinion", (a copy of which is attached at Annex 12).

5.12 The current market position shows an average mark-up on PPD in the BIEM Area of 14.1%. Figures supplied by Universal subsidiaries across the EU, illustrating the current mark-up are set out in Annex 8, as noted above. This produces a gross rate of 9.3% and not the 11% rate which BIEM currently insists on. For Universal, the difference of 1.8% represents, in financial terms, approximately *[confidential business secret]* million per annum[53], which costs must necessarily be passed on to consumers.

Discounts[54]

5.13 An underlying principle in arriving at a reasonable royalty is that the BIEM Standard Rate should only be paid on the price actually received for the product. Discounts are a direct cost to record companies and no willing licensor or willing licensee would ignore such a significant element in the cost structure when agreeing a royalty. In this context, Universal considers that arguments advanced by BIEM that copyright owners should not be obliged to contribute to record company

53 Not taking account of the actual position in relation to discounts provided by Universal to its customers.

54 See also paragraph 4.9 and footnote 29 regarding discounts.

discounts are misconceived[55]. As previous Commission practice recognises, discounts are an essential element of business dynamic between record companies and their customers, without which, in all likelihood, pricing flexibility by record companies would be severely limited. BIEM's characterisation of the deductions for discounts as an "allowance" or "contribution" demonstrates the arbitrary and ill-conceived nature of the Standard Rate according to its current method of calculation. The current discount provisions establish discount terms which bear no relationship to actual commercial usage. They are also inconsistent with contractual and licensing practices elsewhere in the industry where, for example, artists contracts routinely recognise and permit discounts to be taken into account when determining the price at which a reasonable royalty rate should be set.

5.14 The Standard Rate should reflect current commercial usage and take full account of the actual free goods/discounts granted by the industry to dealers, on the basis that discounts are only an element of the price and are granted to encourage sales, which benefits the composer, artist, consumer and record company alike. It should be recognised in this regard that the high level of discounts which record companies are required to pay are a direct result of ever increasing commercial pressure from retail customers. The market reality today is that distribution lies in the hands of very powerful customers, who demand hefty discounts from the record companies, and this reality should be, but is not, reflected in the Standard Contract[56]. Indeed, in recent years, competitive forces, from both legitimate and illegal sources, have exerted downward pressure on the margins earned by record companies. Accordingly, costs have had to be adjusted by record companies in order to ensure the economic viability of their operations. One of the cost elements for record companies is the royalties payment to collecting societies for the reproduction of sound

55 For example, in recent discussions between the Nordic IFPI groups and BIEM representatives in January of this year, Ronald Mooij, General Secretary of BIEM firmly indicated that BIEM was unwilling to contribute to or recognise any and all rebates given by the record companies; his objection was grounded on the fact that this would be inappropriate since BIEM had no participation in how these finds were used. An argument which, for the reasons outlined in section 4.9 above, Universal considers misconceived.

56 For example, in Universal's key BIEM Area territories, [confidential business secret] very large retailers, such as hypermarket and superstore chains, (often operation internationally) make up between [confidential business secret]% of Universal's sales in those territories. ([confidential business secret]).

recordings. In order to meet these competitive forces on the downstream market, Universal has moved towards a more flexible pricing structure, involving higher discounts on PPDs being given to retailers. This strategy implies a reduction in Universal's revenues. In a proper competitive market, a reduction in the revenues downstream would be reflected in a reduction of the revenues upstream, thus the reduced margins equally affect all industry players. This is not, however, the reality occasioned by the Standard Contract terms, the consequences of which were clearly condemned in the judgment of the Australian Copyright Tribunal of 14 June 2000, in the Universal Music Australia v EMI Music Publishing Australia case, which provides at paragraph 15:

> *the manufacturers' attempt to shift the royalty base away from the list price should not be seen as a frivolous case. The evidence suggests that changes in market conditions and market behaviour have reduced the profitability of selling records. The maintenance of a royalty based on the list price of a record, at least when the list price varies*
>
> *significantly from the actual selling price, may unduly burden the manufacturer to the advantage of the copyright owner..*[57]

5.15 Although it may appear at first glance that record companies are paying a lower Standard Rate now than previously, in reality, the Standard Rate has remained the same, since any gain resulting from small royalty reductions has been obliterated by record companies having to increase their discounts considerably to customers given the very power which these customers now enjoy compared to 1985[58]. BIEM has consistently refused to take into account the realities of the market place. As was recognised by the Copyright Tribunal in the BPI v MCPS case, the failure to take into account true discount rates "is an advantage to the copyright holders who are cushioned from such market forces".

5.16 The fact that actual discounts granted are not taken into account when the royalty payment is calculated represents a disincentive to granting discounts. The cost to the record company of discounting a CD by €1 is greater than it would be if this discount automatically reduced the royalty payment. The upshot is likely to be less use of discounts (coupled perhaps with a lower average PPD) than would otherwise be the case. Thus BIEM is able to use its pricing mechanism as a

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57 This judgment was an interim judgment in an action brought by Universal in Australia challenging the basis on which the Australian royalty rate was then calculated. In the event, a final trial did not take place as the case was settled out of court and the rate of 8.7% from 2002 was agreed. (The new agreement includes minimum royalties but not maximum tracks)The previous rate had been 9.306% and included both minimum royalties and maximum tracks.

58 See paragraphs 4.7 to 4.9 above.

means of directly or indirectly influencing selling prices and other trading conditions in a manner inconsistent with Article 81(1). These arguments apply equally to the provisions of the Standard Contract relating to the current minimum royalties levels and the maximum tracks/playing time restrictions, the legal arguments concerning which are discussed in more detail below.

The Standard Rate Does Not Reflect Current Commercial Usage

5.17 The present Standard Rate and its method of calculation are based on incorrect assumptions and totally fails to reflect the current commercial usage underlying the market for sound carriers today as the figures provided by Universal demonstrate. As such, the current Standard Rate is excessive, arbitrary, and unfair and clearly constitutes a direct infringement of Article 81(1), (and in particular, Article 81(1)(e)). This conclusion was endorsed by the Swiss Competition Authority which states in its Opinion that:

> *"in our view, the present Tariff is out of date. In particular, it is questionable to choose, as a basis for calculating the Tariff, a wholesale price which is largely of a fictitious nature and, quite obviously, differs from reality systematically and substantially..."* (emphasis added)

Reduction in collecting societies' costs not reflected

5.18 There have been additional changes in the market which should be, but are not reflected in the Standard Contract and which should lead to a change in the current Standard Rate. For example, collecting societies have been able to reduce their overall costs significantly. As already noted, Universal calculates that as a result of complaints by music publishers, the societies' commission rates have come down from a weighted average of some 10.83% in 1984/85 to nearer 6% today. These reductions have not led, as might have been expected, to any reduction in the rate to customers. If such reductions had been passed on, Universal estimates that its effect would be equivalent to an approximately 0.5% reduction in the royalty rate.

5.19 As the Commission is aware, the Cannes Agreement was a trade-off by the societies to aim for a more efficient and cost effective service for their members in return for music publishers dropping their attempts to introduce direct distribution, (i.e. a method of royalties distribution which would take some collecting societies out of the chain of administration and management; the aim of the publishers being to avoid payment of unnecessary commission fees and time delays in processing the rights). Pursuant to the Cannes Agreement, a 28% reduction on the previous average

commission rate was agreed, giving a new average commission rate of 6% on mechanical royalties on sound carrier sales to be introduced by 2001 for all repertoire. Such reductions reflected an acceptance by collecting societies that significant management inefficiencies have existed and that these can be eliminated without any cross subsidisation from their other activities. Indeed, it appears to Universal that whilst the collecting societies have been prepared to take account of their members' wishes to modernise and bring up to date commission rates, they have not been prepared to extend the same principles to their arrangements with users. The societies are seeking to pay for these inefficiencies and the quiet life afforded by their monopoly position, by charging excessive royalties to their customers. Collection of mechanical royalties is ultimately just a data processing function. Universal estimates that a reasonable commission rate would not exceed 3 to 4%, yet currently commission rates are above 6% on average and this is even after the significant reduction to rates made as a result of in the Cannes Agreement. In addition, as noted above, even this level of reduction, achieved as a result of the Cannes Agreement and the trade-off in relation to direct distribution, has not translated into any benefits for users and has not resulted in the level of mechanical fees being reduced. By virtue of its monopoly position, BIEM (and its members) is sheltered from competition since it faces low incentives towards increasing its own productivity levels and also, it has no incentive to pass on any gains deriving from productivity gains.

5.20 In contrast, the record producers have, as a result of the increasingly competitive nature of the market for sound recordings, been required to spend more in order to achieve sales. The European average marketing spend as a percentage of sales, for example, has increased from 12% to 17% from 1993 to 2001. Such marketing costs have not however been reflected in an adjustment of the Standard Rate. Record companies' discounts have in general increased significantly over the last decade, whilst the Standard Rate has reduced only very slightly and disproportionately.

Article 82

5.21 As is well established in the jurisprudence of the ECJ, collecting societies are required by Article 82 of the Treaty of Rome to act within the limits "absolutely necessary' for the attainment of their objects. The ECJ has indicated on a number of occasions that where a dominant collecting society imposes obligations which are not absolutely necessary for the attainment of its objects, this may

result in an unjustified encroachment upon its members' freedoms to exercise their copyright and a threat to competition[59].

5.22 Not only have abusive licensing practices been condemned by the Court of Justice[60], but negotiated' rates have also been held to be unfair in existing jurisprudence. For example, in Hilti[61] the ECJ examined the royalty rate in a patent licence which was on offer and concluded that it was abusive even though it had been offered in the context of negotiations between the parties. The issue being one of relative bargaining power, the almost total absence of bargaining power on the part of IFPI members in the context of the Standard Contract is clear from the entrenched positions of dominance held by BIEM and the Relevant BIEM Members, by virtue of the manner in which rights are compulsorily transferred under reciprocal agreements and the binding nature of the Standard Contract resulting from Article 7 of the BIEM Statutes. Historically, the balance of power has been with BIEM and it still is, since record companies wanting to sell sound recordings have no alternative source of supply for the licensing of the mechanical rights. The decision of the UK Copyright Tribunal[62] endorsed this view. The decision noted that BIEM's stance in negotiation showed a *"rigidity. . . characteristic of the wielding of a monopoly right"*

5.23 Licensing, therefore, at an artificial and arbitrary rate (such as BIEM is doing by means of the Standard Contract in its current form) is abusive of its dominant position. Moreover, given their monopoly positions, the societies have a "special responsibility", alongside BIEM, to ensure that their conduct does not impede genuine and undistorted competition in the relevant market[63]. Clearly, this responsibility has not been fairly discharged by either BIEM or its members.

5.24 Article 82 itself lists as an example of an abuse "...imposing unfair...selling prices.... Existing EU case law is consistent with the case supported by the figures produced by Universal in relation to current levels of discount and mark-up and for the reasons set out below that, the current standard

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59 See for example Case 127/73 BRT v SABAM ECA 51; Case 7/82 GVL v Commission ECR 483; Case 125/78 GEMA v Commission ECR 3173.

60 See for example the decision in Case T-51/89 Tetra Pak.

61 Case T-30/89 ECR 11-1439.

62 [1993] EMLR 83

63 As established by the Court in Case 322/81 Michelin -v- Commission ECR 3461, paragraph 57.

rate is unfair within the meaning of Article 82, insofar as there is no “reasonable relation” between

the economic value of the goods or services provided and the price (royalty rate) charged[64]. The value of the composer's mechanical rights depends on the profit that the user of the right can make from it. Such value clearly falls when, for example, the user is forced by a change in competitive conditions to offer his own customers a higher level of discount. Furthermore, the ECJ has established that Article 82 prohibits making the conclusion of contracts subject to acceptance of supplementary obligations which by their nature and according to current usage, have no connection with the subject of such contracts. The ECJ has applied this principle to the pricing practices of dominant firms which limit the commercial freedom of customers[65]. Universal firmly considers that such analysis is clearly applicable to the discount provisions (and other provisions see below) included in the Standard Contract..

5.25 In addition, as already noted, a reasonable proxy to determine the unreasonableness of a royalty is by reference to comparables, as the ECJ noted in *Tournier*.[66] A schedule setting out rates applied elsewhere in the world, (set out in Annex 3) demonstrates that, as mentioned above, the Standard Rate is the highest Royalty rate applied anywhere in the world in relation to the licensing of mechanical rights where the structure of the industry is similar. There is no objective reason why the Standard Rate should be higher for the licensing of the same rights in all of the jurisdictions.

MINIMUM ROYALTIES

Article 81(1)

5.26 Article VI (1) of the Standard Contract provides that a minimum royalty of two thirds (rounded up to 67%) of the standard royalty on the prices most generally practised for each format by IFPI members in the relevant country, will be paid on sales. This level of minimum royalty requirement results in a very significant increase in the percentage standard rates charged on sound recordings

64 See for example, the decision in Case 395/*87 Ministère Public v Tournier ECR 2521. The ECJ confirmed in Tournier that an undertaking abuses its dominant position where it has an administrative monopoly and charges for its services fees which are disproportionate to the economic value of the service provided. (as reiterated by the ECJ more recently in Société Civile Agricole* C-323/93 ECRI-5077).

65 See for example Hilti -v- Commission Case T-30/89 II ECR 0163).

66 See above footnote.

which are sold at less than 67% of average full price[67]. The actual standard rate on some recordings can in fact increase from 9.009% to 20% or more as a result of this current minimum level requirement. This is completely contrary to normal licensing practice in the music and other similar industries. For example in artists' agreements, the practice is to allow a decrease in royalties where the relevant full price is not charged. In the book publishing industry a lower standard rate is allowed for the paperback edition, to reflect the lower margins. It is relevant to note in this regard that in its recommendations to the Swiss Arbitration Commission, discussed above, the Swiss Competition Authority reached precisely the same conclusion and went so far as to recommend that the minimum royalties provision be abolished:

> *"If the price of a sound carrier is reduced, the profit achieved when utilising it, is equally reduced. It is essentially in accordance with market and system principles that the royalties will be lower in this case. By contrast, imposing a minimum remuneration cannot be described as conforming to market requirements."*

5.27 Minimum royalties were established at BIEM's insistence in order to prevent records being sold at a low price level, which according to BIEM would result in an "unworthy" royalty for authors and composers. In practice, the effect is that below a certain PPD, record companies do not pay the normal 9.009% percentage rate but a fixed royalty. For example, in Germany, a CD single having a PPD below €5.50, will attract a royalty of approximately €0.50, and the same €0.50 royalty will apply for a CD having a PPD of €3.50, rather than the €0.31 applicable if the 9.009 percentage rate was applied. These provisions can result, and do result in this current situation, in very serious consumer detriment since they affect, in particular, sales categorised as "budget" (sold at less than 50 % of full price) and the majority of "mid-price" product sold at less than 67% of full price which constitute an increasingly important section of the market. Approximately *[confidential business secret]%* of Universal's total net sales in Germany were caught by the minimum royalties provision in 2001. The result is detrimental to consumers because it has the effect of stopping the release onto the market of new budget-priced product and discouraging a reduction to budget price of older mid-priced product.

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67 The average full price is agreed between the BIEM member and the local IFPI member on a territory by territory

Minimum royalties not justified under Article 81(1) in non-exclusive licences of this nature

5.28 In Universal's view, the interference with record companies' pricing policies occasioned by the current level and unrealistic inflexibility of the minimum royalty level provisions, in the circumstances and market conditions relating to mechanical royalties, leads to serious distortion of competition contrary to Article 81(1). In this regard, the existing operation of minimum royalties in the context of the Standard Contract must be distinguished from the situation of an exclusive licensee where in order to ensure that the exclusive licence produces and/or sells a reasonable quantity of products (typical of patent licensing agreement), minimum royalties are generally deemed compatible with the competition rules. However, this is not the case in a non-exclusive licence in the circumstances surrounding the BIEM Standard Contract. Indeed, the operation of minimum royalties in the context of the Standard Contract leads, in this particular case, at present, to precisely the opposite result, having a negative effect on the quantities of records sold by inflating the level of royalties in relation to categories of sound recordings which are particularly price sensitive to a level which means that output is limited or prevented entirely because it removes any economic incentive to produce certain categories of sound recordings; as a result, price competition in the market for sound recordings is limited and distorted. In these circumstances, the current minimum royalty provisions constitute horizontal pricing agreements between the societies which have a serious distortive effect on prices charged to the consumer and as currently imposed, are not worthy of exemption.

Minimum royalties limit production

5.29 The current minimum royalty level provisions in the Standard Contract result in a potential reduction in the production of low-priced records to the detriment of consumers and therefore ought, in their existing application, to be viewed as a breach of Article 81(1)(b).

5.30 Reduced price sound recordings enable composers to obtain additional royalties long after the original release. The main economic rationale of budget and mid-price records is to provide a new marketing opportunity for old works; and composers, as well as record companies, substantially benefit from the incremental sales. This, therefore, both represents an important source of inter-brand competition, with Universal's competitors and provides considerably more scope for intra-

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basis. In addition. the minimum royalty is applied at a reduced level for recordings which are re-released at budget price.

brand competition, between different types and categories of Universal's own products. In fact,

given the increasing use of lower price categories to extend record sales and the clear price advantages of so doing, the effect of the restrictions imposed by current the minimum royalty level provisions is to limit the price competitiveness of such works and their availability to the public at large. The level of the minimum royalty is such as to make certain pricing levels and types of recording economically unattractive, to the detriment of all rights owners and ultimately consumers. Whilst it is difficult to give precise estimates of the proportion of mid/budget priced products affected by the existing minimum royalties level restriction, it is clear that its effect is to distort the normal distribution of low price records and to prevent record producers setting prices according to market conditions so as to maximise sales of each category of products (see Annex 16). In Germany, approximately *[confidential business secret]* % of Universal products sold are affected by the current minimum royalty restriction. For example, the abolition of the minimum royalty restriction would produce annual savings to Universal of approximately *[confidential business secret]* million in respect of sales in Germany alone.

5.31 These arguments find support in the Copyright Tribunal's decision in BPI v MCPS, which in fact ruled against minimum royalties:

> *"A minimum royalty would, on the figures before us, constitute a very substantial rise in costs for records - indeed making the cheapest variety wholly unviable... Moreover the argument overlooks the fact that budget records breathe new life into old works and that the lower royalty per record is often more than compensated for by substantially increased sales..."*
>
> *Further, the object and effect of a minimum royalty is to upset the normal distribution of costs on low priced records in favour of composers. We find no commercial justification for such special treatment at the expense of the other participants in the record."*

5.32 Worked economic examples also supporting these arguments and demonstrating the economic impact of minimum royalties can be found at Annex 16.

5.33 For these reasons, Universal therefore considers that the unrealistic level of the current minimum royalty requirement in the Standard Contract operates anti-competitively, to the detriment of record companies and consumers and, for the above reasons, breaches Article 81(1) without any applicable pro-competitive justification that would entitle the requirement to an exemption according to Article 81(3).

Minimum Royalties and Article 82

5.34 Precisely the same legal arguments apply to an analysis of the minimum royalties under Article 82, i.e.:

- by virtue of its dominant position, BIEM is able to abusively impose licensing requirements that are completely contrary to normal licensing practices in the music and other similar industries; for example, by requiring a minimum royalty payment that in some cases can increase the actual royalty payable from 9.009% to 20% or more; (see paragraphs 5.24 and 5.25 above);
- such minimum royalty requirements, as currently operated, are not objectively, realistically or commercially justified, nor are they indispensable for the potential consumer and industry beneficial aims of the Standard Contract. There is no reasonable relation between the economic value of the rights provided and the royalty paid[68]. The current requirements therefore result not just in an unfair Standard Rate for record companies and other users of the rights, but also in an unjustified encroachment on Relevant BIEM Members' freedom to exercise their copyright competitively;
- such minimum royalty requirements, as currently operated, negatively impact on the quantities of records sold by inflating the level of royalties in relation to categories of sound recordings (i.e. mid and budget-priced product) which are particularly price sensitive, to a degree which effectively results in the limitation or distortion of output of such recordings by the record companies due to the fact that they may become economically unattractive to produce (see paragraphs 5.24 to 5.29 above and a worked example of this effect set out at Annex 16). An example of this is that minimum royalties impact on box sets where typically a number of CDs will be boxed together and sold at substantially less than the full price per CD. This often triggers a minimum royalty charge that can make such release uneconomic. As a result, box sets are mainly used in classical repertoire (where much of the repertoire is in the public domain and therefore no copyright royalty is charged), but rarely for pop repertoire unless for high value, collectable products which can be priced at full price.

5.35 The increase in PPD rates which results from the imposition of the current level of minimum royalties amounts to abusive conduct on the part of BIEM and/or the Relevant BIEM Members, within the meaning of Article 82. BIEM is effectively dictating, from a position of dominance, how Universal, in a position of dependence, should run its business, by the imposition of the minimum royalties currently provided for in the Standard Contract and by making certain pricing levels and types of recording currently economically unattractive, to the detriment of rights owners and consumers alike.

5.36 It is Universal's submission that these provisions, as currently imposed, infringe the principle which prohibits pricing practices by dominant firms which limit the commercial freedom of customers, i.e. the minimum royalty provisions are a specific form of pricing which limit the commercial freedom of the customer and therefore contravene Article 82. Moreover, the ECJ has established that Article 82 prohibits making the conclusion of contracts subject to acceptance of supplementary obligations which by their nature, according to current usage, have no connection with the subject of such contracts and has applied this principle to the pricing practices of dominant firms which limit the commercial freedom of customers. Universal firmly considers that such analysis is clearly applicable to the existing minimum royalty provisions included in the Standard Contract[69].

MAXIMUM TRACKS/PLAYING TIME

Article 81(1)

5.37 Clauses VI(5) to (10) of the Standard Contract establish the number of complete protected works or fragments of protected works which may be reproduced on the same format, (e.g. disc, cassette, mini-disc) having regard to its playing time and its type. Clause VI(6) stipulates that if a producer wishes to reproduce, on the same format, a number of protected works or fragments exceeding that permitted, the total royalty due will be increased in the same proportion. Universal considers that the maximum tracks and limitation on works provisions infringe Article 81(1) because they discourage production of those sound recordings, thereby limiting output

68 See also paragraph 5.22 and footnote 55 above.

69 See for example Hilti –v- Commission Case T-30/89 [1991] II ECR 01163).

predominantly of compilation discs, which include a large number of tracks. Over the last 10 to 15 years, compilations, in particular multi-artist compilations, have become an increasingly important part of the market and the number of tracks included in a compilation album continues to rise. Compilations may be of older material, thus giving past hits a "new lease of life" and generating royalties for artists and copyright owners long after the initial selling period. Alternatively, such compilations may consist of more recent hits which extend the period of time during which current hits generate revenue and which stimulate the purchase of artist albums from which hits are taken. Compilation discs enhance consumer choice and increase price competition. The maximum tracks provision is especially punitive in relation to compilation albums which have lower margins than single artist albums because they are heavily marketed and have a short life span. Furthermore, the maximum tracks provision can mean that albums are released as double albums rather than single albums so as to avoid attracting the maximum tracks royalty uplift. This leads to an increase in the PPD and subsequently the retail price as a result of increased packaging and manufacturing costs. The economic impact of the limitation is to detract from the possibilities of fully developing the markets for these products and in so doing, limits output, stifles innovation and therefore infringes in particular Article 81(1) (b).

5.38 The net Standard Rate is charged in respect of each reproduction of a specified maximum playing time (which varies according to the format concerned). BIEM introduced restrictions in the Standard Contract (pursuant to Article VI(5) of the Standard Contract) which provide that in excess of this playing time the record companies must pay an additional royalty. Article VI (5) provides as follows:

> *"The number of complete protected works or fragments of protected works which may be reproduced on the same disc having regard to its playing time and its type is as follows:*

I	*45 rpm 17cm Single*	*(up to 8 mins)*	*2 works or 6 fragments*
II	*45 rpm 17 cm EP*	*(up to 16 mins)*	*4 works or 12 fragments*
III	*45 rpm Maxi-single*	*(up to 16 mins)*	*4 works or 12 fragments*
IV	*33rpm 17 cm EP*	*(up to 20 mins)*	*6 works or 18 fragments*

VI	*33 rpm 30 cm LP*	*(up to 60 mins)*	*16 works or 28 fragments*
VII	***CD Single of 3 or 5 inches***	***(up to 23 mins)***	***5 works or 12 fragments***
VIII	*Norma! CD of only 5*	*inches(up to 80 mins)*	*20 works or 40 fragments*
IX	*Single Cassette*	*(up to 8 mins)*	*2 works or 6 fragments*
X	*Maxi Cassette*	*(up to 16 mins)*	*4 works or 12 fragments*
		(up to 30 mins)	*10 works or 24 fragments*
		(up to 60 mins)	*16 works or 28 fragments*
		(up to 120 mins)	*32 works or 56 fragments*

5.39 As mentioned above, all of these restrictions impact heavily on certain recordings - predominantly compilation discs and singles. Compilations usually involve a large number of tracks to stimulate the consumer to purchase a compilation of catalogue singles and can exceed the relevant maximum tracks restriction of 24 works[70]. This has the effect of raising the mechanical copyright rate charged by Relevant BIEM Members in respect of that category of sound recordings. The provisions also have significant negative impact on the production of singles. Record companies are increasingly seeking to offer consumers better value by offering to release singles with playing times of up to, or even in excess of, 30 minutes or "maxi" singles with in excess of 5 works on them. The excess playing time alone would result in a royalty rate payable by record companies equivalent to 131% of the net rate. Both a maximum tracks/ playing time restriction and a minimum royalty can apply to the same product. For example Universal has considered a promotional campaign whereby a consumer who purchases a Universal CD of a particular repertoire will be given at no charge a six-track CD sampler of similar repertoire by a variety of artists to stimulate sales of the albums of artists featured on the sampler As a promotional product, the recording artists waive their respective royalties entitlements on sales of the sampler in recognition of its promotional value. In contrast the net royalty rate payable on the sampler to the BIEM member is increased by the provisions of the Standard Contract, as follows:

(a) the maximum tracks provision (the sampler contains six tracks and the Standard Contract limits singles to five tracks); or

(b) the playing time provision (if the playing time exceeds 23 minutes); and

(c) the minimum royalties provision (as the sampler is sold at substantially below 67% of the usual single price).

The result is that the record company is less likely to employ such promotional strategies due to the disproportionate mechanical royalty charge thereby reducing consumer benefit and the promotional impact on sales from which BIEM Societies would benefit.

5.40 The compilation market, in particular, has become a very significant market since 1985 - for example, in both Germany and the Netherlands, compilation albums represented [confidential business secret]% of Universal's total turnover in 2000 in each territory[71]. In Belgium, this figure equated to of *[confidential business secret]* % total turnover in the same period. In Germany, it is not uncommon that the effects of the works and fragments limitation is to increase the royalty rate payable under the Standard Contract for CD singles, albums or compilation albums to a figure which in some cases may be as high as *[confidential business secret]* % simply because the album contains a number of tracks exceeding the limits set. In Germany alone, where the distorting impact was greatest, Universal was forced to pay *[confidential business secret]* in copyright surcharge for the year 2001 as a result of the maximum tracks restriction.

5.41 The maximum playing time and limitation on works provisions are arbitrarily imposed under the Standard Contract and bear no relationship to any technical constraints, nor does the resulting rate reflect the price charged by record companies for those reproductions. Moreover, BIEM's argument (in seeking to justify these arbitrary restrictions) that these provisions prevent the royalty being reduced by division between a large number of composers and a dilution of authors' earnings, is fallacious. Logically the more tracks appearing on a compilation album, the more attractive the album becomes. As a result the volume of sales is likely to be enhanced, as a result of which authors, record companies and the collecting societies all benefit (therefore imposing these restrictions and preventing record companies from including as many tracks as desired can actually operate to the detriment of BIEM's members). The consumer also benefits by the availability of a

[70] Include Article Vi, (5 ter) in table at para 5.38 - 24 tracks for compilations.

greater range of attractive product. Universal estimates that the abolition of the

[71] Universal estimates based on 2000 figures.

maximum tracks/playing time restrictions would provide savings for Universal of annually across the BIEM Area.

5.42 Universal agrees with the views of the UK Copyright Tribunal which found firmly against maxima. It ruled:

> *"We consider it reasonable that the record company should pay the same rate of royalty per record of given format whether that record contains one or many tracks."*

5.43 For the reasons provided above, the provisions of the Standard Contract relating to maximum tracks and playing time infringe Article 81(1) and do not merit exemption in their current form.

Maximum Tracks and Playing Time and Article 82

5.44 The anti-competitive effects of the maximum tracks provisions described above are further entrenched by the dominant position held by BIEM and/or the Relevant BIEM Members. As with the case of the Standard Rate and the current level of minimum royalties imposed, the provisions on maximum tracks extend beyond what is "absolutely necessary" for the attainment of BIEM's objects.

5.45 The effect of these limits is contrary, in particular, to Article 82(b) in so far as they discourage/limit the production of types of sound recordings, predominantly compilation albums, to the ultimate detriment of consumers. Indeed, the limitations have the effect of aggravating the deterrent to production of these sound recordings already resulting from the imposition of the current minimum royalties provisions. The effect of the BIEM contract is to discriminate against these works by applying special provisions to the calculation of royalties. There is no objective justification for paying a different rate of royalty by reference to an arbitrary limit on the number of tracks on an album. The whole basis of calculation of a royalty is by reference to the particular format and price and to charge supplementary payments in respect of individual works on the format by reference to arbitrary criteria cannot be justified.

5.46 These provisions (as in the case of the Standard Rate and current minimum royalties) also infringe Article 82(a) by imposing a specific form of pricing which limits the commercial freedom of the customer (see paragraph 5.36 above).

6 EXEMPTION

6.1 Whilst Universal considers that a Standard Contract could, in certain circumstances, benefit from exemption, (for example if it applies fair and reasonable terms, (including rates)) the system which currently applies under the Standard Contract is not capable of exemption in its present form[72]. For the reasons described above, the Standard Rate is neither fair nor reasonable. The Commission has always regarded any interference with price competition as a particularly severe infringement of Article 81(1) and clearly there must be a compelling justification for it to be capable of exemption pursuant to Article 81(3). In addition, in this context, it should be noted that the minimum royalties (applied in their current form and level), the maximum track provisions and the current discount allowance serve to aggravate the unfairness of the Standard Rate and substantially increase the effective rate. Moreover, all the matters complained of as falling within Article 81(1) are imposed by BIEM from a market position which affords it the possibility of eliminating competition in respect of a substantial part of the services to which they relate. In view of this, in its currently operated form, this provision cannot qualify for exemption under Article 81(3).

6.2 As demonstrated above, each of the current terms of the Standard Contract complained of ultimately works to the detriment not just of record companies, (as explained in detail in this Complaint — see in particular section 5), but also to the detriment of consumers, i.e. by depriving them of lower prices and a wider choice of product; therefore these terms, as currently applied and operated, clearly do not qualify for exemption by reference to the criteria set down in Article 81(3).

6.3 Moreover, none of the above terms complained of by Universal can be categorised as "indispensable" to achieve any of the objectives specified in Article 81(3). The failure and refusal to recognise true discounts and mark-ups applied by the industry, the currently unfair and inflexible calculation and application of minimum royalties and the limitations on the numbers of tracks, works and fragments, all have the practical economic consequence of limiting the production of goods and maintaining prices at a higher level than that which would otherwise be applicable.

6.4 Finally, Universal would emphasise that in relation to the Article 82 aspects of the Complaint, there is no question of exemption of unjustified, clearly abusive conduct by a dominant entity under EU

[72] Article 7 of the Standard Contract, if it were reasonable and could be objectively justified, would be capable of exemption.

competition rules/procedure.

7 ORDERS SOUGHT

Universal requests that the Commission make the following declarations and orders under Article 3 of Regulation 17/62:

- A declaration that the Standard Rate is too high;
- A declaration that the operation of the current terms of the Standard Contract, in particular, those relating to (i) the level of mark-up and discounts taken into account when calculating the Standard Rate, (ii) the current minimum royalties levels imposed and (iii) maximum track/playing times, also infringe Article 81(1) without qualification for exemption under Article 81(3);
- A declaration that the operation of the current terms of the Standard Contract outlined in the above point also constitute an abuse by BIEM and the Relevant BIEM Members of a dominant position;
- A declaration that intervention by BIEM in the national negotiations is unlawful;
- An order that BIEM and the Relevant BIEM Members cease to include in the Standard Contract terms which, by their nature or according to commercial usage, have no connection with the subject matter of the Standard Contract, in particular as regards the actual current levels of discounts granted by record companies, the current levels of minimum royalty payments imposed and the inclusion of the maximum track/playing times requirements;
- Such other remedies as the Commission considers appropriate.

8 CONTACT DETAILS

8.1 Universal should be pleased to provide any further information or additional documentation which the Commission may require in considering the Complaint.

8.2 It would be helpful if all enquiries concerning the Complaint could in the first instance be directed to Universal legal representative:

Stephen Kon

SJ Berwin
222 Grays Inn Road
London WC1X8XF
Tel. 00 44 (0)20 7533 2222
Fax. 00 44 (0)20 7533 2000

S J Berwin
Square de Meeüs 19
1050 Brussels
Tel. 00322511 5340
Fax. 00 322511 5917

8.3 A proof of authority to act confirming Universals appointment of its legal representative is set out in Annex 17.

8.4 The representative at Universal for this Complaint is:

Richard Constant

Universal Music International Limited
8 St Jamess Square
London SW1Y4JU
Tel. 00 44 (0)20 7747 4000
Fax. 00 44 (0)20 7747 4499

ANNEXES/SUPPORTING DOCUMENTATION