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CASE COMP/C2/38.440 UNIVERSAL vBIEM

RESPONSE BY UNIVERSAL MUSIC INTERNATIONAL LIMITED TO THE REPLY BY BUREAU INTERNATIONAL DES SOCIÉTÉS GERANT LES DROITS DENREGISTREMENT ET DE REPRODUCTION MÉCANIQUE, DATED 6 SEPTEMBER 2002

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INTRODUCTION

This Response to the Reply dated 6 September 2002 by the Bureau International des Sociétés Gerant ("BIEM") ("the BIEM Reply") is in three parts.

At Part A is a Rejoinder to the case advanced by BIEM in its Reply. The Rejoinder is not intended to be a point-by-point analysis of everything said in the BIEM Reply, but rather is intended to provide an overall rebuttal of BIEM's principal submissions.

Part B of the Response is a Report prepared by Professor Janusz Ordover, Professor of Economics at New York University and former Chief Economist for the Antitrust Division of the Department of Justice ("the Ordover Report"), in which Professor Ordover provides an economic assessment in support of Universal's complaint ("the Complaint") and also replies to the economic arguments advanced in the BIEM Reply.

At Part C is a Schedule which responds on a point-by-point basis to many of the individual statements and arguments relied upon in the BIEM Reply, many of which are inaccurate, misleading or not relevant to the issues raised by Universal in the Complaint.

Terms used in this Response are defined in the Complaint.

PART A: REJOINDER

Introduction

Before responding to the principal arguments advanced by BIEM in reply to the Complaint made by Universal Music International Limited ("Universal") dated 31 May 2002 ("the Complaint"), it is worthwhile recalling that the Complaint does not challenge the principle of collective licensing or the continued operation of the Standard Contract. As we explain further in section 1 below, it appears that on occasions, BIEM loses sight of the core of the Complaint; which is that certain provisions of the Standard Contract which establish the terms upon which all collecting societies are obliged to contract with recording companies, including the Standard Rate which is established as a result of the operation of those terms, infringe Article 81(1) and/or Article 82 of the EC Treaty and Article 53(1) and/or Article 54 of the EEA Agreement.

As Universal explains in detail in the Complaint, and as is subsequently developed in the Ordover Report, the Standard Contract is capable of operating as a pro-competitive instrument in delivering a BIEM area solution to the licensing of mechanical rights and in maximising efficiency gains in the administration of those rights provided its terms are proportionate and do not prevent, restrict or distort competition. However, the current provisions of the Standard Contract and the resulting Standard Rate produce manifestly disproportionate and anti-competitive effects. In particular:

- The mark-up component of the Standard Contract, which is based on conditions prevailing in 1985, produces an arbitrary and disproportionate effect. It has made the Standard Contract unresponsive to changed market conditions, insulating collecting societies from market developments by ignoring the significant decreases in average retailer mark-up on PPD since 1985 upon which the Standard Rate was fixed.
- Similarly, the discount structures within the Standard Contract are fixed without reference to market conditions which are now out of date. They ignore the very significantly increased discounts which recording companies have been required to grant retailers because of changed market conditions and in particular, retailers' increased market power.
- The minimum royalty provision equally ignores the need to use targeted discounts to encourage sales. It weakens the ability and incentive of record companies to price CDs at low

price points or even to issue budget CDs, a category of product which is particularly price sensitive, in the first place. Consumers suffer as a result of prices that are higher than they might otherwise be and a reduction in the diversity of available music. To the extent that budget CDs are more likely to be used as a vehicle for lesser-known artists, they also are harmed, since their music is less likely to be put on sale.

- As with the minimum royalties provision, the maximum track/playing time provision of the Standard Contract acts as an inefficient restriction on the production of CDs, to the detriment of record companies, the publishing community and consumers alike. It harms consumers because of the resulting decrease in music output. Lesser-known artists are disproportionately harmed as their work is more likely to be cut by any reduction in the number of songs included on a compilation CD. We now turn to reply to the principal submissions relied upon in the BIEM Reply.

1 BIEM's overall position that its members should be insulated from market realities is untenable: the BIEM Standard Rate ¡s imposed on recording companies; it restricts price competition and limits output to the detriment of BIEM's own membership

B/EM considers that the Standard Rate should be disconnected from market realities and bears no impact on consumer prices for sound carriers.

1 .1 The BIEM Reply fails to address one of the fundamental arguments advanced in the Complaint. In the Complaint, Universal demonstrates that the terms of the Standard Contract which are the subject of the Complaint and the resulting Standard Rate are being exploited by BIEM to insulate its members from market realities and thereby enable BIEM and its members to produce, both jointly and severally, an anti-competitive outcome in imposing the Standard Contract upon Universal and other recording companies. Much of what is said demonstrates a complete disregard by BIEM of the current realities of industry conditions. As noted in the Ordover Report, insofar as collective bargaining is acceptable under the competition rules because of certain efficiencies and other benefits conferred by collecting societies and their members acting collectively, it is essential that the current regime replicates to the greatest extent possible the

outcome that would be obtained if market forces were to prevail.[1] For the reasons explained in the Complaint and expanded upon in these submissions, the Standard Contract and the Standard Rate fail to deliver this objective.

1 .2 The fact that collecting societies are insulated from market forces was recognised by the UK Copyright Tribunal, which noted that *"the agreement to stick to PPD* (alone) *therefore is an advantage to the copyright holders who are cushioned from such market forces".*[2] Far from the BIEM Reply providing evidence to rebut Universal's submissions in this regard, it only reinforces the strength of Universal's case. While BIEM appears to acknowledge in the opening paragraph of its Reply the importance of market forces in assessing the compatibility of the Standard Contract with Articles 81 and 82, when it observes that: *"competition law in fact aims at an environment of undistorted competition where prices are determined by the* ***interplay of market forces.****"* (emphasis added), throughout the rest of the Reply, BIEM goes out of its way to emphasise that its members <u>should</u> be insulated from competitive realities and <u>should not</u> be required to take full account of current market conditions in the royalty and discount terms and imposition of the minimum royalties and maximum track provisions.

1.3 As Universal explains in the Complaint and these submissions, including the Ordover Report at section III, there has been a shift in the relative risks and returns characterising the activities of Universal and other recording companies which distorts the competitive impact of the offensive terms of the Standard Contract and the Standard Rate and which necessitates adjustments in both the framework through which royalties are paid under the Standard Agreement and the level of royalties. This is further exacerbated by the significant change in the overall condition of the market for recorded music. As the Ordover Report demonstrates, adjustments in the way in which the mechanical rate is calculated can offset the potential imbalance of the parties' risks and returns and better align their incentives to invest.

1.4 In the past, BIEM itself has recognised the principle that licensing terms should take account of current commercial realities. For example, in 1985, when royalties based on retail prices were converted to PPD, as required by the Commission, BIEM accepted that the royalty *"up-lift"* should

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1 At paragraph 21.

2 CT 7/90 BPI y MCPS, 1 November 1991

be based on the actual differences prevailing between PPD and retail price at the relevant time, not at some token date some twenty-five years earlier. Yet now it wishes that no account should be taken of the significant downward movement in the *"up-lift",* as retailers face more competition in the sale of recorded music. The 8% royalty figure based on recommended retail price[3] was converted to a wholesale price based figure of 11%. Using the retailers' estimated average mark-up on PPD in 1985 of 37.5%, Universal estimates that current average retailer mark-up over PPD has now decreased to approximately 14.1%. The consequence is that the PPD based headline royalty rate based on current average retail mark-up would be only 9.13% instead of the 11% currently in place.[4]

1.5 In the past, BIEM has also recognised the need to take account of discounts but in practice any increases in discount allowances granted by BIEM have been cancelled out by increases in actual discounts, still leaving actual discounts considerably in excess of the allowance. The question is, again, should the discount allowance be some arbitrary amount by reference to discounts prevailing at some earlier time when the then prevailing competitive conditions have no relationship to current commercial conditions, or should the discounts allowance be consistent with current commercial usage and reflect the revenues which are currently generated by the licensed works? Although BIEM argues that discounts are outside their control, so are PPDs, which only re-emphasises the need to take account of commercial realities. In Universal's submission, it is clear from the terms of Articles 81 and 82 in general and the reference in Article 81 (1)(e) to current commercial usage, that the compatibility of the offensive provisions of the Standard Contract, and therefore the Standard Rate, with Articles 81 and 82 must take account of the current discounts that record companies are compelled to grant to retailers.

1.6 In these circumstances, it is surprising that at various parts of the Reply, BIEM seeks to question the meaning of the references in the Complaint to "commercial usage", notwithstanding the fact that reference to this term is used in Article 81(1)(e) of the EC Treaty and has obvious relevance to any assessment under Article 81 of the Standard Contract and in the past, BIEM has been

3 Paragraph 56 of the BIEM Reply.

4 Paragraph 56 of the Ordover Report.

prepared to take account of commercial usage and consider the Standard Contract in its proper current market context.

1 .7 BIEM also insists that royalty rates have no impact on consumer prices,[5] and believes that the matters which are the subject of complaint can be overcome by changes in the commercial policies provided by recording companies. Not only is this view unrealistic, but BIEM's suggestions as to what changes to make appear designed to restrict competition and to penalise consumers. For example, BIEM suggests that recording companies limit or entirely withdraw discounts given to their customers,[6] which amounts to a suggestion that recording companies should limit price competition. BIEM also proposes that Universal and other recording companies should interfere with retailers' prices.[7] BIEM further suggests in a number of statements that it is right that creators should be indifferent to the key competition policy objectives of lowering prices, increasing output and thereby improving consumer welfare. BIEM's blinkered and patronising view of the market leads it to conclude[8] that the key to competition in the music sector should be innovation rather than price competition. BIEM clearly believes that royalties should be disconnected from competition in the market place and should be unrelated to consumer prices.[9] It considers that whatever investment recording companies may make in order to increase the overall sales of recorded music and maximise sales revenues should be entirely disregarded in assessing the reasonableness of licensing terms and royalty rates. For example, at paragraph 221, BIEM asserts:

"We do not see why creators should do the same as artists: to give up income in recognition of 'promotional value '."

Similarly, at paragraph 201, BIEM asserts that: 'The protection of intellectual property, and of culture and cultural diversity, requires that the risk business of the majors should have no effect on the income of Creators." -

1.8 At paragraph 91 of the Reply, BI EM states "consumer prices are determined by the majors and do not depend on royalties". As a matter of fact, this is a ridiculous proposition; for Universal,

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5 Paragraph 87 of the BIEM Reply.
6 Paragraph 162 of the BIEM Reply.
7 Paragraph 98 of the BIEM Reply, which amounts to a proposal that the majors should influence the pricing policies of supermarkets and other non "specialized" retailers.
8 At paragraph 101 of the BIEM Reply.
9 Paragraph 225 of the BIEM Reply.

mechanical royalties represent a cost of 10.8% of the PPD which is appreciably more than Universal's manufacturing costs for a CD. Moreover, BIEM, in fact, contradicts itself on the impact of mechanical royalties on consumer prices; as Ordover notes:

"BIEM itself contradicts this point when it argues that the minimum royalty provision makes it less desirable for record companies to offer CDs at 'bargain basement' prices. B/EM has not explained how one provision of the Standard Contract can affect pricing decisions, but the mechanical royalty rate does not. Given BIEM's apparently contradictory position, and the fact B/EM's assertion contradicts fundamental economic principles, it is clear that BIEM's argument should not be given any credence."

It is worth recalling within this context that an essential requirement for recording companies in the pricing of sound recordings is the need to develop flexible pricing structures which must constantly be adapted to consumers' perceptions of quality and value, which change from time to time. This was acknowledged by the UK Monopolies and Mergers Commission ("MMC"),[10] which observed as follows in relation to the pricing of CDs:

"1.13 The record industry is a high-risk business. The great majority of recordings do not sell enough copies to recoup their initial investment. Record prices must therefore be set so that the earnings on successful records will cover losses on the failures. It would not be sensible for the record companies to price CDs, cassettes and vinyl records strictly in relation to manufacturing costs, which make up only a small proportion of the total costs. Instead record companies have developed pricing structures for different recordings and different formats which reflect consumers' perceptions of quality and value and hence willingness to pay. Given the strong competition in the market we believe this pricing policy is justified.

2.7 The cost of making a record, including the artists' advance and costs of a video, can be very significant Thus a large number of copies then need to be sold before the record company will recover its initial costs. How many will be sold. is difficult to predict in advance, particularly as only a small proportion of the pop artists signed by a record company actually achieves success."

1.9 Against this background, input costs such as mechanical royalties are an essential element in overall pricing decisions that will be adopted by Universal and other recording companies. Indeed, if consumer prices are simply decided by the majors, as BIEM claims, one might reasonably expect the Member State in which the PPD is lowest to have the lowest average retail price. In fact, if one compares the PPD for the three Universal titles listed in Annex 9 of the BIEM Reply to average retail prices for (broadly) the same period set out in Annex 5, no such correlation appears to exist, at least not in any consistent way. For example, a Shania Twain album, a full price product, had a

10 MMC Report CM 2599 into The Supply of Recorded Music, dated June 1994.

PPD in Austria in 1999 of *€11.26,* the lowest in the EEA, whilst its average retail price in Austria was *€15.62,* the fourth highest in the EEA. Similarly, a mid-priced Bon Jovi album sold in 1999 had a PPD in Finland of €6.54, the second lowest in the EEA, but an average retail price in Finland of €17.17, the third highest in the EEA. Budget priced products equally show no consistent correlation between low PPD and low retail price. ABC's CD, "Look of Love", had a PPD in Sweden in 1999 of €4.96. the third highest in the EEA, but an average retail price of €14.89, the highest in the EEA.[11]

The Imposition of the Standard Contract on Universal

1.10 BIEM denies that the Standard Contract is "imposed"[12] upon Universal. lt accepts, however, that the effects of Article 7 of the BIEM Statutes provide a "homogeneous legal environment"[13] for the licensing of mechanical rights. In making this statement, BIEM overlooks the fact that it is this very homogeneity which leads to a complete absence of competition in the market for the licensing of mechanical rights throughout the BIEM Territory. As a result, BIEM also ignores in turn the special responsibilities[14] incumbent upon it, as a monopoly association of undertakings which creates and co-ordinates that very homogeneity, to ensure that the licensing terms it imposes are fair and proportionate and produce a competitive, rather than an anti-competitive, outcome. The suggestion by BIEM that the Standard Contract is not imposed upon the recording companies or that they have any choice in licensing terms does not bear scrutiny; the inter-play between the BIEM Statutes and, in particular, Article 7, the Standard Contract and the Reciprocal Agreements, removes any real or effective competition between collecting societies and removes all licensing options for recording companies. The complete dependency of recording companies on the collecting societies (and, therefore, upon BIEM) and the fact that recording companies have nowhere else to go was recognised by the UK Copyright Tribunal.[15] The UK Copyright Tribunal further observed: 'indeed, whilst all the record company costs (labour, artists, royalties and so on)

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11 Universal notes that BIEM's Annex 9 related to an average retail price for all titles, rather than individual titles as set out here. However, Universal believes that its comparison is illustrative.

12 Paragraph 42 of the BIEM Reply.

13 Paragraph 36 of the BIEM Reply.

14 See the XXI Vth Report on Competition Policy (1994), point 204.

15 At page 7, paragraph 32 of its Decision.

are subject to competitive forces, the record licence royalty is not".[16] The fact is that recording companies are a one-product business. With the exception of music out of copyright and a very limited number of alternative sources of income (which Universal estimates to constitute no more than 10% of its total revenue), Universal is totally dependent upon mechanical copyright licences; without such licences, Universal would not be able to record music and sell sound carriers.

Collecting societies are less dependent on recording companies

1.11 Table I of the Ordover Report[17] shows that in contrast to the dependency of recording companies on collecting societies, collecting societies and their publishers have a number of alternative sources of income available which makes them far less dependent on recording companies for their income. Table I shows that in the relevant European Union territories, mechanical income as a percentage of music publishing revenue ranges from 14% to 40%. This compares to the position for recording companies; for whom access to a licence for a mechanical right from BIEM is analogous to an essential facility. Whilst it acknowledged that BIEM is not denying access to a licence per se, it is however denying access to a licence on reasonable terms, and that licence cannot be replicated.[18] Such a licence is not only necessary or desirable, but it is indispensable to enable a recording company to undertake its business activities.[19]

1.12 As stated above, Universal is only being granted access to the BIEM member societies' repertoire on unreasonable terms which bear no relationship to the commercial realism in which sound recordings are marketed today. This disconnection with market forces fulfils the definition of a dominant position first given by the ECJ in *United Brands*[20]*:*

"a *position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording ¡t the power to behave to an appreciable* ***extent independently of its competitors, customers and ultimately of its consumers****."* (emphasis added)

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16 At page 8, paragraph 7 of the BIEM Reply, BIEM selectively quotes a single sentence of this paragraph of the Tribunal's Decision: "Composers need the record companies; without records, most composers would not get far these days." Without making any reference to the Copyright Tribunal's findings as regards absence of competition in the grant of mechanical licences.

17 Referred to in the Ordover Report at paragraph 33.

18 See, by analogy, Notice on the Application of the Competition Rules to Access Agreements in the Telecommunications Sector (1998) OJ 265/2 at paragraph 68.

19 See case Case C-7/97 *Oscar Brönner y Mediaprint* (1998) ECR l-7791. The European Court of *Justice held that a body which controls a facility that is essential to operate in a market is only required to give access to that facility if it is indispensable rather than merely desirable or useful for market entry.*

20 Case 27/76 *United Brands y Commission* ECR 207.

1.13 The ECJ recognised in *United Brands*[21] that the essential test to determine whether an undertaking in a dominant position is abusing that dominant position by charging excessive or unreasonable prices, is to determine whether it is using the opportunities that flow from that position of economic strength to draw transactional advantages that it would not otherwise be able to draw in a competitive environment. That is manifestly the case as regards the advantages which BIEM is trying to draw from Universal in relation to the offensive terms of the Standard Contract and the Standard Rate. As noted in one of the leading works on EU competition law:[22]

«L 'imposition de prix excessifs est l'une des conséquences les plus nuisibles des monopoles: n'ayant aucune concurrence à redouter, ils peuvent fixer les prix à un niveau injustifiable, rejetant la demande vers d'autres produits ou services dont la production est artificiellement stimulée, ce qui a pour résultat de détourner les forces productives de l'économie vers des activités moins prisées et d'empêcher la satisfaction optimale des besoins des consommateurs. Il ne s'agit pas à proprement parler d'une pratique anticoncurrentielle, c'est-à-dire d'une pratique visant à ***éliminer la concurrence*****,** *mais d'une pratique rendue* ***possible par l'absence de concurrence et*** *consistant à exploiter les opérateurs situés soit en aval, soit en amont."* (emphasis added)

The practical consequences of Universal's Complaint

1.14 BIEM asserts in its Reply that if proper account is taken of actual discounts given to retailers and the minimum royalty and maximum tracks provisions were removed, this would result in a lowering of collecting societies' income. It follows, in BIEM's view, that the grant of discounts by recording companies should have no effect on the income of creators.[23] However, as the Ordover Report demonstrates,[24] no record company will give its customers higher discounts or, for example, incur substantial promotional costs that may lower that company's overall profitability, unless that record company believes that this will lead to increased sales and therefore increased income for collecting societies.

1.15 The fact that lower prices for CDs and the resulting stimulation in sales, can increase income to the publishing community is also demonstrated by the tables and graphs at Annex I. These set out sales figures for the CDs of a number of Universal's artists. In particular, they show the effect on sales volumes of targeted discounts of CDs to mid price. The sales figures for Bon Jovi albums, for example, show that when the PPD was reduced to mid price in September 2000, there was almost an eight-fold increase in sales. When the PPD was reduced again to mid price in March

21 *At* paragraph 249.

22 Megret: Le Droit de la CE, 4, Concurrence, Section 542.

23 Paragraph 201 of the BIEM Reply.

24 At paragraph 79 of his Report.

2001, there was a similar increase in sales volumes. The striking increase in sales volumes for artists such as Marilyn Manson, PJ Harvey and Texas can only partially be attributed to increased exposure from tours and when compared with the effect of price discounts on The Cure, U2 and Bon Jovi, it becomes apparent that it is predominantly due to a reduction in PPD. On the specific question of discounts, maximum tracks and minimum royalties, Professor Ordover points out that the removal of each and every one of these provisions from the Standard Contract is likely to allow recording companies to offer more products to consumers, in particular benefiting lesser known composers whose songs would otherwise not feature on compilation albums; to stimulate sales volumes through more effective, targeted discounting policies; and to increase sales at budget prices in order to stimulate greater sales volumes of CDs of recording artists and composers featuring on such CDs. The Ordover Report notes that all three effects will, under plausible conditions, lead to greater total revenue from royalties for creators and emphasises the resulting identity of interest between recording companies and collecting societies to achieve this objective.

1.16 As Ordover noted in the same context, ~j~ investments made by record companies to increase sales ultimately inure to the benefit of the publishing community. For example, collecting societies benefit from recording companies' marketing spend to promote sales without having to share in any of these costs at all. Often such marketing spend will be incurred to simply maintain sales. This is illustrated by Annex 2, which shows a dramatic increase in Universal's marketing spend as a percentage of sales in order to make equivalent sales.

1.17 The essential contradiction in BIEM's position and its insistence on ignoring market realities is illustrated by the fact that it ignores entirely the fact that a reduction in price and therefore a boost to sales could, in principle, always be achieved by a reduction in PPD. Indeed, given the support which BIEM appears to give to a PPD based royalty[25] it is surprising that it has not recognised this. As the Ordover Report notes, however,[26] insofar as greater discounts are a reflection of sharper competition, *"simple economics would predict that owners of inputs would also be compelled to lower the fees for their services. This is the outcome one would expect in any industry in which market-based bargaining between individual buyers and sellers is the norm. In fact, even the*

25 See, for example, paragraphs 60 and 70 of the BIEM Reply.

26 At paragraph 70.

outcome produced via collective bargaining would generally reflect the exigencies of the competitive situation in the relevant market place". Ordover goes on to show why, in his view, the publishing community is likely to be better off if the recording company is able to boost or at least maintain sales by targeted price cuts through discounts as opposed to the more blunt method of an across-the-board reduction in PPDs.

2 Universal supports the principle of collective licensing; but it must produce a reasonable, proportionate and competitive outcome

2.1 A clear example of how BIEM has attempted to divert the Commission from the main issues lies in the several pages of text it has devoted to justifying the existence of copyright management societies, such as its members. BIEM goes to great lengths to justify its members' existence, to the extent that it has tied itself in knots in trying to say that on the one hand, composers are not obliged to use the services of collecting societies,[27] whilst on the other, the only practicable means of controlling and managing their rights is for composers to become members of a collecting society.[28] BIEM appears to have sought to give the impression that Universal is in some way challenging the very existence of collecting societies.

2.2 This is not the case. Universal makes it clear from the outset of the Complaint and thereafter on numerous occasions that it is entirely supportive of the principle of collective licensing and indeed, Universal is not seeking to challenge the existence of the Standard Contract. This could not have been more clearly stated than where Universal says in the Complaint that it: "*would emphasise ... that it is **not** attacking in this complaint the existence of ... collective licensing per se ... 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).*"[29] Universal reiterates that it accepts entirely that the case law of the Court of Justice supports the proposition that copyright management societies pursue legitimate aims when they seek to safeguard the rights and interests of their members vis-à-vis the users of recorded music; however, the consistent case law of the court also supports the proposition that the exercise of such legitimate objectives by

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27 See, for example, paragraph 15 of BIEM's Reply, where it asserts *"Membership is voluntary."*

28 See, for example, paragraph 24 of BIEMs Reply which states that *"Only the system of copyright management* societies *enables all creators to benefit from the use of their works."*

29 See paragraph 1.4 of the Complaint

collecting societies can be restrictive of competition when they exceed the limits of what is *necessary* for the attainment of those legitimate aims. A determination is therefore required as to whether the objectives of the offensive provisions of the Standard Contract and therefore the Standard Rate are *"absolutely necessary"*[30] or *"proportionate"*[31] to achieve any legitimate aim being pursued by BIEM and its collecting society members.

2.3 At no point in the BIEM Reply is any evidence *provided* to demonstrate, as required by Article 81, the proportionality or absolute necessity of maintaining in force the contractual terms which are the subject of complaint and which lead to a system for calculation of the Standard Rate which is divorced from market conditions. BIEM suggests at more than one point in its Reply that a collective licence may be jeopardised if Universal's submissions are accepted,[32] which is an absurd scenario. There is an assumption that Universal is attacking the very existence of collective licensing which, as already noted, is incorrect. Equally, no attempt is put forward by BIEM to seek to provide any economic or empirical justification for the offensive provisions of the Standard Contract and the Standard Rate by reference to Article 81(3). The responsibilities of collective licensing bodies under competition law are well established. The UK Monopolies and Mergers Commission noted in its report into the activities of Phonographic Performance Limited that:

"collective licensing *bodies... are by thefr nature monopolistic - indeed the potential for effectiveness depends in large measure on the extent of their monopoly - and it is widely accepted that appropriate controls are needed to ensure that they do not abuse their market power".*

2.4 The gravamen of Universal's Complaint is that the relevant provisions of the Standard Contract covered by the Complaint and the Standard Rate seriously restrict or distort competition in the market for recorded music in general and result in higher pricing and restrictions in output. It is to be recalled that Article 81(1)(a) EC prohibits any restrictions in price competition. Similar reasoning, which is particularly relevant to the minimum royalty and, maximum track clauses of the Standard Contract, led the Commission to find that the Net Book Agreement constituted a

30 See Case *127*/73 *BRTvSABAM* ECR 51 at paragraph 31.

31 See *Case* 395/87 *Ministére Public y Jean-Louis Toumier*

32 Paragraphs 25 and 233 to 238 of the BIEM Reply.

restriction of price competition in Cases IV/27.393 and IV/27.394, *Publishers' Association – Net Book Agreements* when the Commission observed:

"The agreements and the rules restrict competition between publishers, for once they decide to impose a fixed resale price, they are almost totally prevented from adapting the conditions governing the application of such fixed resale price (in particular the exceptions thereto) to the commercial potential of the books concerned on the market and from offering more freedom than the agreements provide to resellers as to the exceptions they may apply to such fixed resale prices. (~...) The fact that, if a publisher decides to impose a fixed price for a book, he is then bound to impose almost – wholly uniform conditions – i.e. the same conditions as other parties to the agreements are bound to impose – upon resellers as to the discounts they may give to their customers, is sufficient to make the agreements and implementing rules restrictive."

2.5 In footnote 129 of its Reply, BIEM seeks to distinguish the *Visa Interchange Decision* and argues that the normal principles for application of Article 81 to price fixing agreements do not apply to the Standard Contract. It claims the *Visa* case is distinguishable because recording companies negotiate through IFPI and have superior bargaining power over BIEM, compared to the retailers that were required to pay the interchange fee in the *Visa* proceedings. Such an analysis does not bear scrutiny. First, as already noted, the recording company members of IFPI have no source of mechanical rights other than BIEM and in that regard, have no bargaining power. Secondly, each recording company (unlike members of BIEM) is free to negotiate outside the auspices of IFPI and therefore, again, in that regard IFPI has no bargaining power. Thirdly, BIEM seeks to characterise the retailers paying the interchange fee in *Visa* as small and weak, compared with recording companies. Yet those retailers include, in fact, all of the most powerful retailers and other commercial operators (such as national airlines, major hotel groups and the like) world-wide; is BIEM seriously suggesting that major undertakings such as all those that accept Visa cards are without bargaining power or have less bargaining power than Universal or other record producers? The answer is manifestly no and in Universal's submission, nothing in the BIEM Reply provides any answer to Universal's submission that the relevant provisions of the Standard Contract and, as a result, the Standard Rate, constitute appreciable restrictions of price competition which cannot be justified pursuant to Article 81(3). There is simply no evidence to support the BIEM suggestion[33] that creators would become "disinterested" in collective licensing if Article 81 is applied to them in this manner. Rather, for reasons given by Professor Ordover, there is every

33 A paragraph 234 of its Reply.

reason to believe that collecting societies will continue to prosper with composers continuing to receive proper remuneration for their creative efforts.

3 Comparables with third countries are highly relevant to a determination of excessive royalties in the EU

3.1 At paragraphs 179 to 186 of the BIEM Reply, BIEM devotes several pages of inaccurate and misleading statements to the comparisons drawn by Universal between BIEM's standard royalty rate and rates in other territories. First, BIEM insists that a comparison of rates in the Community with rates in third countries is inapplicable. In this regard, BIEM relies on Case 395/87, *Tournier,* concluding that this case establishes that only comparisons with other Member States are valid when comparing rates from one collecting society to another. BIEM is either being disingenuous or does not understand the context of the *Tournier* case. The case establishes that comparisons may be made as part of an exercise into assessing whether a particular rate indicates that there may be an abuse of a dominant position. Furthermore, as the Commission is aware, the *Tournier* case concerned a royalty rate applied in France. The most apt comparison, therefore, was with royalty rates in territories as similar as possible to France. Logically, therefore, comparisons were made with royalty rates applying in other Member States. In this case, the BIEM rate, with the exception of the UK and Ireland, applies throughout the EEA, so it is absurd to say that comparisons should be limited to the Member States. Following the logic of the *Tournier* case, the most suitable comparison is therefore with non-EEA territories, especially larger territories such as the USA and Japan. The point made in the Complaint, which is ignored in the BIEM Reply, is that comparables such as those put forward in the Complaint are relevant since we are comparing the price or "rents" payable in respect of exactly the same rights. Comparables question what is the justification for material differences in the rate which the publishing community can extract in respect of the same works in different and broadly comparable territories. One of the essential questions is whether the price charged would be charged in a competitive environment.[34]

[34] See D Schwarz "Imposition de prix non équitables par les entreprises en position dominante' in La réglementation du comportement des monopoles et entreprises dominantes en droit communautaire, Bruges, 1977, p 381, 385 and 386; S Gabriel, "Preiskontrofie im Rahmen der Wettbewerbspolitik", Tubingen, 1976; I Schmidt, "US — Amerikanische und Deutsche Wettbewerbspolltjken gegenüber", Markmacht, Berlin, 1973, p 164; and W Emmerich, "Die höchstrichterliche Rechtsprechung zum GWB", ZHR, 1976, p97-115.

3.2 BIEM seeks to justify further its rejection of comparables by pointing out[35] that the mere existence of royalty disparities is not conclusive of an "abuse". However, as Advocate-General Jacobs indicated in his opinion in *Tournier*

> *"The existence of substantial disparities between the level of the royalty imposed by the dominant copyright management society and those imposed by copyright management societies in other Member States (if established by objective methods of comparison) will* ***give rise to a strong inference that*** *the royalty imposed by the dominant society is excessive, with the consequence that it will be incumbent upon that society to justify the level of the royalty."* (emphasis added)

This view was supported by the Court at paragraph 38 of its judgment, which indicated that appreciable disparities *"must be regarded as indicative of an abuse of a dominant position'~*

In light of the evidence which has been adduced relating to the share of risks and rewards between the publishing community and record companies and the clear anti-competitive effect of the cartel-like application of the Standard Contract and in particular the provisions relating to the rate, fixed discounts, minimum royalties and maximum tracks, the comparison of the Standard Rate with comparable rates in major territories around the world does indeed point to the Standard Rate being unreasonably high.

3.3 Finally, in relation to this "indication" of an abuse, BIEM rightly points out that it could present an objective justification for the price disparity. It is notable, however, that BIEM has explicitly not furnished any empirical evidence to support such a justification, although it has sought to reserve its right to do.[36] As the judgment of the Court and the Advocate-General in *Tournier* makes clear, the burden of proof is upon BIEM to justify such disparities and this BIEM has singularly failed to do in the Reply. It is nonsense for BIEM to claim that the use of comparables leads to *"a worldwide race to the bottom".* They provide a reasonable proxy to determine the reasonableness of the Standard Rate and those comparables clearly point to that rate being too high.

4 The Commission is the Forum Conveniens: it is entirely consistent with the objectives of EU competition law and policy to consider the compatibility of provisions of the Standard Contract leading to the Standard Rate with Articles 81 and 82

4.1 At paragraphs 1 to 3 of the BIEM Reply, BIEM claims that Universal is effectively asking the

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35 At paragraph 182.

36 *See* footnote *118 of BIEM's Reply.*

Commission to act as a price regulator and it claims that this constitutes a misuse of EU competition law. This is incorrect. Universal has not asked the Commission to set a price and accepts that such a request would not be appropriate. In this regard, Universal stated early in its Complaint that:

"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. "[37]

Once the Commission determines the legality of the relevant provisions of the Standard Contact and, as a result, whether the Standard Rate infringes Articles 81 and 82, the legal context for the settlement of licence terms would be determined.

4.2 Universal has made a complaint that a number of terms of the Standard Contract infringe Articles 81 and 82. It is anticipated that were the Commission to adopt a Decision in relation to the Complaint, it would take the form of a declaration that the offensive contractual terms and the resulting Standard Rate or the method of calculation of the Standard Rate infringe Articles 81 and/or 82. The assessment that Universal is seeking from the Commission is not materially different to that which the Commission has undertaken in similar cases in the past, such as its Decision in relation to the Net Book Agreement case[38] and the Visa Interchange case. In the Net Book Agreement case, the order made by the Commission was for the Publishers Association to take all necessary steps to bring to an end forthwith the six infringements of Article 8(1)(1) constituted by provisions of the Net Book Agreement. Similarly, in British Ley!and,[39] the Commission found that British Leyland had abused its dominant position by, inter alla, charging an excessive price for certificates of conformity for imported vehicles and ordered the company to "bring the infringement.., to an end." Again, in the United Brands[40] decision, the Commission found, inter a/ia, excessive pricing and ordered that it be brought to an end without delay.

4.3 Subsequently, the BIEM Reply maintains that national arbitration or court proceedings or national competition authorities are the appropriate for a for Universal to present its case.[41] For example, BIEM states at paragraph 115 of its Reply that: "*Nothing suggests that the questions raised in the complaint*

37 *At paragraph 1.4 of the Complaint*
38 *Commission Decision 89/44/EEC of 12 December 1988, IV/27.393 and IV/27.394, Publishers Association - Net Book Agreements.*
39 Commission Decision 84/379/EEC of 2 July 1984, IV/30.61 5-BL.
40 *Commission Decision 76/353/EEC of 17 December 1975, IV/26699-Chiquita.*
41 *See paragraphs 114 to 119 of BIEM's Reply.*

cannot be dealt with through negotiations or by national courts and authorities", at paragraph 118 BIEM suggests that *"national authorities are often in a better position to protect competition".* However, that ignores the fact that the compatibility of the Standard Contract with Articles 81 and 82 clearly falls for determination by the Commission, given the pan-European scope of the Standard Contract and the Commission's exclusive competence (until the entry into force of the "Modernisation" Regulation on the rules implementing Articles 81 and 82 ("the Modernisation Regulation")[42]) to apply Article 81(3). Even after entry into force of the Modernisation Regulation, the Commission will remain competent to deal with complaints which clearly raise important questions of EU competition policy such as the present Complaint.

4.4 The Commission's *Notice on cooperation between national courts and the Commission in applying Articles (81 and 82) of the EEC Treaty*[43] is clear as to the circumstances where the Commission is the *forum conveniens* and when recourse to national courts is more appropriate. It notes, at Article 14, that the Commission *"intends.. .to concentrate on notifications, complaints and own-initiative proceedings having particular political, economic and legal significance for the Community".* Given the significance of the Standard Contract as the most important pan-European collective licensing agreement, the fact that the Commission has examined the Standard Contract in the past and the jurisdictional difficulties and inappropriateness of a single national authority (whether judicial or administrative) determining the compatibility of the BIEM arrangements with Articles 81 and 82, the Commission is clearly the appropriate forum to determine Universal's Complaint.

4.5 Moreover, the *Commission's* Co-operation Notice[44] only reinforces the fact that a complaint which raises important matters of Community interest should be dealt with by the Commission. Article 26 of the Notice states that: *"In principle, national authorities will handle cases the effects of which are felt mainly in their territory and which appear upon preliminary examination unlikely to qualify for exemption under Article 8(1)(3). However, the Commission reserves the right to take on certain cases displaying a particular Community interest."* The Standard Contract applies throughout most of the EEA and its effects are therefore felt across the EEA, rather than any individual Member State.

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42 Council Regulation (EC)No 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.

43 Commission Notice 93/C 39/05.

44 Commission Notice OJ (1997) C313/3.

Universal's submission of a complaint to the Commission is therefore entirely consistent with the guidance provided by the Commission as to the appropriate forum.

5 The BIEM comfort letter does not alter Universal's analysis; and Universal had no involvement in the notification of the BIEM Statutes

5.1 At Annex 2 to the BIEM Reply, BIEM advances a number of arguments to suggest that Universal was in some way involved in the notification of the BIEM Statutes in February 1998, leading to the issuance of a comfort letter in December 2000. While the analysis advanced in Annex 2 may be an accurate "characterisation" of BIEM's own contacts with the Commission, it provides no evidence that Universal (or, indeed, IFPI) had any input (and indeed it did not) into the process of the Commission's consideration of the BIEM Notification or that Universal (or any other recording company) was able to comment on the compatibility of the BIEM Statutes in general or Article 7 in particular as part of that process.

5.2 It is not clear to Universal how BIEM is aware of the details of confidential contacts between the Commission and IFPI during 1997 and 1998, including, it would appear, details of meetings between IFPI and the Commission and responses by IFPI to requests for information pursuant to Article 11 of Regulation 17. While Universal understands that it is correct that IFPI had various contacts with Mr Temple Lang and other officials during the relevant period, it is incorrect to suggest that the focus of those discussions was the BIEM Statutes or the notification of the BIEM Statutes. First, as noted by BIEM itself,[45] the relevant contacts between IFPI and the Commission focused on the Standard Agreement, not on the BIEM Statutes. Insofar as Mr Temple Lang indicated the relationship between the Statutes and the Standard Contract, that was a matter the Commission (apparently) chose to pursue direct with BIEM. The contact between the Commission and IFPI referred to by BIEM dated the notification of the BIEM Statutes and therefore it was hardly possible for IFPI to comment in 1997 on a notification made in February 1998. It is understood that the notification made by IFPI in July 1998 was made precisely because of its concerns in relation to the compatibility of the terms of the Standard Contract and the Standard Rate with Articles 81 and 82. Universal was subsequently told by the Commission that the Commission did not ultimately address the IFPI notification because of the expiry of the 7th Amendment to the Standard Contract.

[45] See Paragraph 18 of Annex 2.

5.3 All other contacts referred to in Annex 2 of the BIEM Reply were between BIEM and the Commission. While Universal cannot be aware of comments that may have been made by Mr Lovergne to BIEM, such as referred to at paragraph 13 of Annex 2, Mr Lovergne does not appear to have passed any comment on the various terms which are the subject of Universal's Complaint, including the level of the Standard Rate, but appears to have made a very general comment on the "PPD system" when it was instituted.

5.4 What is clear is that neither Universal, IFPI nor, it would appear, any other interested third party, was given an opportunity by way of an Article 19 Notice in the Official Journal or otherwise to comment on the notification of the BIEM Statutes and nothing in the BIEM Reply throws any doubt on that position. BIEM notes at paragraph 3 of Annex 2: *'Vie granting of the comfort letter was not withheld from interested parties."* This is entirely disingenuous; there is a one-line reference in the 30th Report on Competition Policy well after the comfort letter was issued which provides no reference to the subject matter of the comfort letter, but simply refers to *"BIEM".* Equally, it is clear that the Commission has kept an entirely open mind throughout the period referred to by BIEM at Annex 2 on the compatibility of the Standard Contract and the Standard Rate with Articles 81 and 82.

ANNEX I

Tables - Demand for CD's *I* Price

(Confidential)

ANNEX 2

Universal's marketing spend as a percentage of sales

(Confidential)