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November 7, 2003

Dr. Herbert Ungerer
Directorate General for Competition
European Commission
70, Rue Joseph II
B-1000 Brussels

Subject: Case COMP/C2/38.440 Universal v BIEM

Dear Dr. Ungerer,

Universal submitted its initial complaint in the present case on 31 May 2002 ("the complaint"). After our initial response dated 6 September 2002 ("the response"), the complainant was given a further opportunity by the Commission to comment and make additional arguments. Universal submitted its second submission on 10 March 2003 ("Universal's second submission"). At this time, BIEM requested the same right of reply as afforded to Universal. BIEM is grateful to the Commission for the time given to consider the second submission of Universal and the opportunity to seek independent economic evidence.

As discussed with Mr. Torben Toft, we hereby submit a rejoinder to our initial submission ("the rejoinder"). The present rejoinder refutes the additional arguments made in Universal's second submission. This rejoinder should only be read in conjunction with the initial submission made by BIEM: In addition, BIEM submits an independent study by NERA which in our view demonstrates the lack of economic data to support the study prepared by Mr. Ordover on behalf of Universal.

BIEM has sought throughout this process to provide the Commission with all the information that the Commission has required. We now believe that all parties, in particular the complainant, have been given ample opportunities to make their case in writing. We hope that the present rejoinder will not spark a further round of consultations with, and comments from Universal. We remain at the disposal of the Commission for any clarifications it may require.

We believe that the additional material that we are submitting further demonstrates the inability of Universal to make a convincing case for an infringement. We thereby apply for a rejection of the complaint without further investigation by the Commission in accordance with Article 6 of Regulation N° 2842/93.

The rejoinder attached is the confidential version. We are currently working with the BIEM members to prepare a non-confidential version and we will forward this to you as soon as possible.

Yours sincerely,

Dr. Gerrit Schohe

Copy: Mr. Torben Toft

MAIN POINTS

1. The purpose of this rejoinder is to respond to Universal's second submission and confirm our request for the Commission to reject the complaint without further investigation in accordance with Article 6 of Regulation N° 2842/93. The complainant has made two attempts to put forward its evidence and singularly failed to make a case. The complaint remains a "fishing expedition" following the failure to achieve Universal's aims in the negotiating process. The complainant bears the burden of proof in accordance with Article 2, first sentence of Regulation N° 1/2003. Despite this responsibility, the complainant has failed to provide detailed business data to substantiate its own case. This leaves a question mark over the intentions of Universal in this case.

2. After reviewing BIEM's response dated 6 September 2002, Universal has been unable to respond to the majority of the points put forward by BIEM and its members. The only new element in Universal's second submission is the economic study prepared by Mr. Ordover. The complainant and Mr. Ordover suggest on a purely theoretical basis that (1) lowering the royalties will lead to a lowering of the wholesale price, (2) lower wholesale prices will cause lower consumer prices, (3) lower consumer prices will cause greater volumes at the retail level, and (4) greater volumes will generate additional revenue for the "publishing community", including the creators. This implies four causal links but the complainant has failed to prove any of these.[1] It seems surprising that Mr. Ordover believes that he can base his analysis of "efficiency" without reliance on economic data, that is to say: on his reflection alone.

3. To respond to the study prepared by Mr. Ordover, BIEM has requested a separate economic study by the independent institution NERA, which is enclosed as **Annex 11**. This study demonstrates, on the basis of concrete evidence, that a decrease of royalties by no means leads to lower consumer prices and to greater profits for the "publishing community". One important point should be kept in mind from the outset: It is only the retailer that sets the consumer price – and not the Record Producer who, like the complainant, seeks to lower the level of royalties.

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[1] See below at point 4 of the present rejoinder.

4. The complainant claims that creators' income will rise if royalties decrease. According to the complainant lower royalties would lead to higher sales volumes and to lower consumer prices. This is a fallacy. The reality is that retailers will set their prices independently of the Record Producers.[2] Retailers are likely to keep prices as high as possible even if their upstream suppliers, the Record Producers, achieve small savings in the form of a reduction of royalties.

5. The complainant contends *ad abundantiam* that BIEM refuses to take account of "commercial usage" or of the "market realities". This ignores the history of collective licensing. BIEM negotiates the income of creative persons. In the interests of these persons, BIEM has the right to refuse further concessions to Record Producers. BIEM is entitled to draw a "line in the sand" during negotiations: BIEM rejects the idea that royalties should follow the marketing decisions of the Record Producers. Those marketing decisions are, legitimately, under the only responsibility of the Record Producers and are consequently beyond the influence of the creators. As a result, creators cannot systematically be burdened with the risks inherent in the marketing decisions of the Record Producers.

6. This rejoinder demonstrates that the complainant has failed to respond to BIEM's response and has produced an economic study based on theoretical assumptions without concrete economic evidence. The complainant has failed to demonstrate (1) a *prima facie case* of an infringement of the competition rules, and (2) a Community interest that would justify an investigation by the Commission. Rather than seeking negotiations with BIEM, Universal has decided to waste the time of the Commission. Universal has been given two opportunities to make its case. The complaint should now be rejected without further action.

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[2] It would be contrary to Community law if Record Producers tried to oblige retailers to charge certain prices.

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A. Preliminary Observations

1. BIEM and its members regret that Universal has felt it necessary to continue its complaint following the response of BIEM. Throughout the whole process BIEM has remained open to a negotiated settlement which can only be in the interests of the industry. Following Universal's second submission and the annexed economic study by Mr. Ordover, BIEM felt it had no choice but to respond to refute the additional allegations and misrepresentations. The purpose of this rejoinder is to refute these additional points and confirm BIEM's request for the Commission to reject the complaint without further investigation in accordance with Article 6 of Regulation N° 2842/93.

2. Two general points are worth highlighting at the outset:

   ? BIEM continues to believe that the complainant remains unable to state what it hopes to achieve from the Commission. At one point it requests "regulatory intervention", yet at the same time refrains from asking the Commission to set a particular royalty rate.[3]

   ? In both of the submissions from Universal, it has failed to discharge the burden of proof. The complainant has *not proved, that the manner* in which BIEM or BIEM Member Societies operate collective licensing *constitutes an infringement*. Because the complainant does not have the necessary evidence, it attempts to shift the burden of proof to BIEM. *It suggests that it is for BIEM to justify rates and royalties and thus misrepresents the burden of proof.* A selection of these repeated misrepresentations is set out in **Annex 12**.

3. Concerning Article 81 EC, the Commission has stated in its comfort letter[4] that the BIEM Statutes do not pose a problem under Article 81 (1) EC. Standard agreements are an integral part of the BIEM Statutes. See Article 2 (3) and 7 (3) (a) of those Statutes. We refer to **Annex 2**, point 8, to the response ("BIEM's contacts with the

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3 Complaint, p. 6, point 1.4, 2nd sentence.

4 Of 4 December 2000 (COMP / 36.941) XXXth Report on Competition Policy (2000), p. 164; see points 126 to 132 of the response.

Commission"). As set out in this Annex, BIEM, in the course of applying for a positive decision under Article 81 EC, provided the Commission with the full facts, including the Standard Agreement (**Annex 3** to BIEM's response). It was on the basis of these full facts that the Commission has issued its comfort letter (Case Comp. / 36.941). There is, thus, no problem under Article 81 (1) EC. As Commissioner *Monti* has stated:

> "It is therefore not possible to claim that the activities of collective management societies are inherently restrictive of competition… [The Commission] considers that collective management must be fully effective within the internal market…" [5] [6]

Consequently, it is not necessary to consider Article 81 (3) EC[7], although, BIEM reserves its rights to make further arguments under Article 81 EC. We will therefore concentrate on the alleged "abuse" within the meaning of Article 82 EC.

I. The Complainant's Inability to Counter BIEM's Response

4. The complainant fails to respond to the points made in BIEM's response. An inventory of uncontested key facts and views is set out in **Annex 13** to the present rejoinder.

(1) According to the complainant, there is one causal link between lower royalties and lower wholesale prices, a second causal link between lower wholesale prices and lower consumer prices, a third causal link between lower consumer prices and higher volumes and a fourth causal link between higher volumes and greater revenue for the publishing community. In the response BIEM invited the complainant to provide proof for these causal links.[8] Neither the

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5 Answer on behalf of the Commission dated 19 November 2002 to written question P-3217/02 by *Arlene McCarthy*, OJ C 242/49 of 9 October 2003.

6 See also response, points 121 seq. ("Non-Applicability of the Competition Rules to Collective Licensing") and points 126 seq. ("No Breach of Article 81 [1] EC").

7 See response, point 132.

8 See points 87 to 93 and at point 193 of the response.

complainant nor Mr. Ordover has been able to provide such proof.[9] Since the complainant has not discharged its burden of proof, the opposite of the complainant's allegations must be deemed to be true: namely that *the complainant simply wishes to pocket the money that it would save on account of further reductions of royalties by the creators.*

(2) Notwithstanding the burden of proof for an "abuse" within Article 82 EC (which remains exclusively with the complainant), we enclose as **Annex 11** the aforementioned economic study by NERA. The NERA study is based on economic data. It shows that there is no appreciable interrelation between lower royalties, lower consumer prices and ultimately the increased welfare of the "publishing community", including creators.[10] The Commission has questioned in the context of lower VAT rates how the consumer might benefit from a decrease of VAT.[11] There is a clear analogy between lowered royalties (which the complainant requests) and decreased VAT. Especially, as such a VAT reduction would in any case be many times greater than a royalty reduction.

(3) The complainant has been unable to explain why, in its view, the application of the Four Points[12] has become an "abuse" within the meaning of Article 82 EC. BIEM and IFPI have implicitly agreed in their Standard Agreement of 1998 that the Four Points were "fair" within the meaning of Article 82 (a) EC. The complainant has been unable to show facts or data which would allow the conclusion that the four points have become "unfair" since 1998:

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9 By "proof", we mean economically conclusive evidence, that is to say: the opposite of mere conjectures, remote possibilities and speculation.

10 See sections 4 and 6 of the NERA study, **Annex 11**.

11 See below at point 108.

12 The "Four Points" are those which we understand the complainant wishes to put in question (despite the blurriness of the complainant's allegations): (1) the standard rate of 9,009 % of the PPD; (2) deductions for retail discounts; (3) minimum royalties; and (4) maximum track numbers. See response, para. 104.

? The complainant, like every Major, disposes of a centralized and comprehensive collection of business data, including, in particular, prices and price movements. However, the complainant makes no reference whatsoever to this data. We can therefore only presume that the complainant's own data does not support the complainant's case.

? The complainant is a member of the IFPI Negotiation Committee.[13] The complainant should therefore be able to answer why the Four Points, in its view, have become "unfair" since 1998.

? In BIEM's response, we expressed the view that creators cannot be required to share the risk that Record Producers incur in marketing sound carriers. This view has now been upheld by national jurisprudence against IFPI.[14] The complainant therefore cannot invoke "changed market realities".

(4) BIEM reiterates that if anything is "far from the economic reality", then it is the 10 % reduction for packaging. BIEM thinks that this should be abolished or at least modified. BIEM reserves the right to challenge this 10 % reduction.[15]

II. The Ordover Report as the Only New Element

5. The only new element in Universal's second submission is the Ordover report. This report is devoid of all probative value. Mr. Ordover, a specialist in economics, believes that he can base his appreciation of "efficiency" of current collective licensing without reference to economic data.

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13 See complaint, p. 16, point 2.17.

14 See Munich Court of Appeals (*Oberlandesgericht München*), judgment of 12 June 2003, Case 6 WG 4 /00, IFPI v GEMA, not yet published. Upon request, we will submit a copy of this judgment to the Commission.

15 See response, points 66, 67 and 241.

III. The Role of Music Publishers and Creators

6. It is extraordinary that the complainant – which controls a large music publishing company – can produce a submission and an economic report which completely dismisses the role of publishers.

7. Music publishers are often the discoverers and the first source of funding for new composers or other creators. Publishers often provide the financial support, as well as the industrial know-how, to launch careers of artists.[16]

8. Music publishers are also very active in promoting their composers' works for synchronisation usages. Record Producers benefit from this promotional work as it generates many opportunities for licensing the related sound recordings. Publishers often also contribute to costs which arise during an artist's or a music band's tour. Despite all this, the complainant makes no mention of the significant contribution of publishers. That is wanton disregard, denigrating and disparaging. The complainant, as a music publisher, has fiduciary duties towards creators.

9. The complainant also ignores the role of creators. The business of the Record Producers is built on creations. The complainant talks about creators as if they were labourers. In the complainant's view, creators should work for $8 to $20 per hour, and should take up another remunerated activity if this pay does not allow them to make a living. There is no mention of the creative process, the talent, the emotion and effort that are put into the creation of the music which entertains the world. Instead, there is a dismissive comment suggesting that because creators get satisfaction from their work, they should lower their financial expectations.[17] It is exactly to prevent such exploitation that Community law fully recognises the essential function of copyrights and other intellectual property rights.

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16 For example, an advance from EMI Music Publishing funded the recording of the first Savage Garden CD. It went on to sell many millions of records worldwide.

17 See Universal's second submission, part B at II. A., para. 15 and III at para. 34.

B. Facts

10. As stated above, the complainant has largely been unable to contest in a substantiated way the statement of facts in our response.[18] These facts are now uncontested. A small number of points require additional correction.

I. Generalities

11. According to Mr. Jean-René Fourtou, the Chief Executive Officer of Vivendi-Universal, Universal Music is "an excellent business – one of the only music companies not to be loss-making".[19] In light of this statement, it is difficult to see what losses Universal Music should suffer on account of the Four Points.[20] By complaining to the Commission, Universal Music tries to lower agreed-upon royalties and to pocket the money thereby saved.

12. Contrary to the complainant, creators are not obliged to become a member of a BIEM society.[21] If they wish to become a member, they can choose the BIEM society of their preference, without territorial or other restrictions. The complainant is not "a one product industry almost totally dependent upon mechanical copyright licences, and [that does not] have no other source of income". The Majors[22], including the complainant, are integrated into huge conglomerates that have many more sources of income than the sale of sound carriers. For example, the complainant, Universal Music, is only a comparatively small entity within the Vivendi group of enterprises. We wonder how the complainant can nevertheless make the allegation just cited? The aggregate bargaining power of the Majors, combined under the auspices of IFPI, is far

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18 See **Annex** 13.

19 See Financial Times of 30 April 2003, p. 1. To our knowledge, in June 2002, the Universal Music Group had an annual turnover of about € 6.3 billion.

20 See, e.g., the position which the complainant takes in its second submission, part C, p. 30 seq., point 47 ("big risk business with a loss of 9/10th of the investments").

21 See response, point 17 and 19; incorrect complaint, point 4.2 and Universal's second submission, part C, p. 11 seq., points 13 to 15.

22 Point 4 of the response.

superior to the bargaining power of BIEM[23]. Acting jointly through IFPI, the Majors hold a position of combined power which may amount to collective dominance on the demand side. By contrast, BIEM and its Member Societies are not-for-profit organizations. Many creators depend on income from mechanical licences, for which BIEM negotiates the necessary framework.[24]

13. The use of PPD for royalty calculation was based on a request by the Commission[25]. Since the conversion to the PPD, the issue of a "mark-up" has become irrelevant (contrary to the complainant's allegations). Contrary to what the complainant misleadingly represents, there is no "arbitrary level of mark-up" on PPD[26] or a "mark-up component of the Standard Contract".[27] According to Article V (4) of the Standard Agreement[28], "the royalty shall be calculated on the highest price appropriate to the copy in question as published *by the Producer* (PPD) with a view to retail sale on the day of outgoing from the depot …" (emphasis added). *The PPD is a price determined by the Record Producers alone,* following their costs of production and including their profit margin. The creators have no way to manipulate this calculation basis, whether by way of a mark-up or in any other way.

14. Contrary to point 49 of the Ordover report, the basic rate of 11% of the PPD was the result of negotiations – and not of a mathematical exercise (see point 58 of the response).

15. Minimum Royalties and Maximum Track Numbers have the same goal: to protect creators against exploitation of their creations at any price and against erosion of the

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23 Incorrect, therefore, Universal's second submission, part C, p. 2, point 1 and p. 8, point 8.

24 Concerning the respective bargaining powers of IFPI and BIEM, the complainant *lightly* discards the Commission's findings under Article 18 of the Merger Regulation on which we relied in point 5, footnote 5 of the response. See part C, p. 2, point 1, p. 33, point 52 and p. 33 seq., point 54 of Universal's second submission. Contrary to the complainant, the draft statement of objections by the Commission, acting as competition authority, constitutes authority for fact-finding in the present case.

25 See complaint, p. 22, point 4.7. See also, for the Commission's repeated request to use the PPD as calculation basis Annex 2 to the response, point 13.

26 Incorrect complaint, p. 10, second bullet point, point 1.10 and complaint, p. 36, points 5.10 to 5.12.

27 We are amazed by the repetition of this incorrect allegation in Universal's second submission, part A, p. 3, introduction, first bullet point.

28 Cited in point 59 of the response.

value of their works.[29] In the response, we have explained (1) that the current protective system (e.g., "minimum royalties", "minimum budget royalties") stems from free negotiations between BIEM and IFPI[30], and (2) why this system has never had an impact on consumer prices.[31] In Universal's second submission, the complainant has not contested these two essential points. It only repeated a generality ("inefficient restriction")[32] [33], and even this generality is not backed up by any proof. According to the complainant, BIEM and BIEM Member Societies are able "to dictate the pricing strategy … of record companies".[34] This is absurd. Record Producers take autonomous decisions on prices. As we will show below[35], the impact of royalties on sales prices is minimal.

16. According to the complainant, "BIEM and its members have the advantage of sharing in the positive effects of increased sales."[36] The truth is that creators are always limited to the percentage of the PPD which represents their royalty. By contrast, Record Producers can realise marginal profits by increasing their sales volume. The cost of *production* of a new sound carrier (performing the work and translating it to a disk) are comparatively high. By contrast, the cost of manufacture of each additional ("marginal") sound carrier ("reprint") will be low. Each additional sound carrier results in additional profit for the Record Producer, once the fixed production costs are recouped. The complainant and its economic expert have not furnished the slightest proof that record Producers share that additional profit with creators. In fact, they simply put it in their pockets.

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29 The function of minimum royalties and maximum track numbers can be compared to the function of minimum wages, that protect workers against exploitation at ridiculously low wages.

30 See response, point 73.

31 See response, points 87 to 93.

32 See Universal's second submission, part A, p. 3 and 4, Introduction, 3rd and 4th bullet points. See response, points 71 to 93.

33 The complainant wrongfully contends that Minimum Royalties and Maximum Track Numbers do not correspond to market realities. See Universal's second submission, part C, bottom of page 28. According to the technical specifications of the CD and CD's published by Philips and Sony in 1982 (the so-called "red book"), storage capacity of a CD audio of five inches is 74 minutes digital stereo, and that of a CD single of 3 inches is 20 minutes. In practice, these limits may go up to 79 or, in the case of a single disc, up to 22 minutes. The provisions in the Standard Contract are 80 minutes for a CD and 23 minutes for a CD single. See Article VI 5 of the Standard Contract.

34 See complaint, p. 10, third bullet point.

35 At para 84 et seq.

36 See complaint, p. 12, point 1.10, 7th bullet point.

17. It is not without importance to note that in its direct dealings with artists and creators, the complainant treats artists and creators much worse than it is treated itself under the Standard Agreement.[37]

(1) BIEM has a copy of a model contract between the complainant and an artist. This contract shows that the complainant imposes on artists extremely onerous terms.

(2) Concerning creators we refer to the description by the President of the National Music Publishers Association (NMPA) of the United States system in **Annex 10** to the response.

II. The Determination of Royalties

18. Mr. Ordover finds two of our submissions contradictory[38]: (1) On the one hand, we showed that royalties and retail prices do not have to move in tandem (points 87 et seq. of the response); (2) on the other hand, we insist on minimum royalties and maximum track numbers in order to protect creators against exploitation. Contrary to Mr. Ordover, these two positions are consistent. The first position addresses a marketing risk. The second position limits that risk in the interests of creators: Creators receive a minimum royalty – whatever the pricing decisions or the track-numbering decisions by the Record Producers may be. These two positions complement rather than contradict one another.

19. Contrary to point 57 of the Ordover report, we insist that *there is no evidence, whether in the Ordover report or elsewhere, that Record Producers share increased income, if any, with creators* (or, in Mr. Ordover's parlance, "with the publishing

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37 Universal's second submission, part C, p. 3 to 4.

38 See, e.g., point 83 of the Ordover report; see also *id*. at point 56.

community"). Mr. Ordover himself admits that he cannot predict "how exactly a musical recording's overall return is split …".[39]

20. Contrary to point 68 of the Ordover report, a removal of the minimum royalties[40] does not automatically lead to lower consumer prices or to the sale of a greater number of titles. An excellent example of this is provided by the United Kingdom. Sales in that country are not subject to minimum royalties. There is no evidence that the absence of minimum royalties does lead to lower consumer prices or to the release of more titles in the United Kingdom than elsewhere in the BIEM area.[41] In addition, the removal of this provision would hurt creators.[42]

21. Contrary to footnote 68 of the Ordover report, BIEM has never accepted that the maximum track provisions discourage the production of certain technical formats. The decision of Record Producers to produce certain formats depends on factors others than maximum track provisions.[43]

22. Contrary to point 77 of the Ordover report, *it is the quality of the tracks on a sound carrier, and not their number, that attracts the consumer.*[44] *It is flawed to assume that the maximum track provision would harm lesser-known composers*[45] *as the notoriety of the artist is as important as that of the composer to attract consumers.*

23. Contrary to the complainant[46] the negotiations of a new Standard Agreement have never been terminated. BIEM has always been prepared to negotiate. Informal discussions between BIEM and IFPI occur frequently. These discussions also concern the substance of the Standard Agreement.

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39 See point 59 of the Ordover report.

40 Explained in points 74 to 78 of the response.

41 See section 4 of the NERA study, **Annex 11**.

42 See section 6.2.2 of the NERA study, **Annex 11**.

43 See point 85 of the response.

44 Few people buy carriers of music that they do not like.

45 See point 81 of, and footnote 72 in, the Ordover report.

46 See Universal's second submission, part C, p. 18 seq., points 28 and 29.

24. Our final point of fact is the most crucial: It is the complainant's *leitmotiv*[47] that BIEM refuses to take account of commercial usage or of market realities, and that royalties should follow the income of the Record Producers in tandem or in cascade. This is wrong. *The history of collective licensing abounds in concessions which BIEM has made in order to take account of market realities*.[48]

25. However, taking account of commercial usage or of market realities does not mean that BIEM automatically follows any marketing decision that the Record Producers may take. *BIEM rejects an automatic linkage of royalties to commercial practices of the Record Producers* (in cascade or "move in tandem"). BIEM negotiates the income of creative persons who have entrusted themselves to one of the BIEM societies. BIEM does not negotiate the greatest possible congruence between royalties and the marketing decisions that the Record Producers take. *Like any negotiator, BIEM has the right to say "This far and no further!"*

26. In summary, it is not a question of principle whether or not BIEM is flexible and takes commercial usage or market realities into account. Rather, BIEM looks at each alleged "commercial usage" or "market reality" and decides in each individual case whether it is reasonable to take account of this factor. There have been cases in the past where the pressure from the record industry had been so great that BIEM had to make a concession in order to reach a deal, although BIEM thought it was not reasonable that the alleged "commercial usage" should affect the creator's royalty rate. However, creators cannot be systematically burdened with the risks inherent in the marketing decision of the Record Producer. Nor is there any obligation on the creators to do that. The Munich Court of Appeals in a recent hallmark decision[49] has clearly confirmed this simple principle.

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47 See, e.g., Universal's second submission, part C, p. 8, point 8; and response, points 9 to 11; see further Universal's second submission, part C, p. 29, point 44.

48 See points 61 to 67 of the response.

49 See footnote 14 of the present rejoinder.

III. Mr. Ordover's Mistaken Yardstick

27. Mr. Ordover's core contention is that creators in their own interest should happily agree to "linked royalties", that is to say to royalties that move in tandem with the discounts and other pricing policies of the Record Producers. This contention is fundamentally flawed.

28. Mr. Ordover believes that the creation of a song or other music is exclusively a question of time (10 hours per work) and of the hourly rate (US$ 25). If this "business" does not allow the creator to make a living, Mr. Ordover contends that the creator would walk away from creation and look for another source of income. We fundamentally disagree: It is ridiculous to equate time-bound jobs (for example those of a repairperson, or that of a worker in an automobile manufacturer's factory) with the work of a creator. The work of a creator requires musical or lyrical gift, intuition, imagination and often years of training and practice. It involves the risk of illness or change of taste or fashion. By using the parameters of time spent and of hourly rates Mr. Ordover chooses the wrong yardstick to measure the "efficiency" of creative writing. Perhaps the whole notion of "efficiency" is inadequate as regards the fruit of musical or lyrical gift, intuition and imagination as the success or value of a work does not depend on the time dedicated to its elaboration.[50]

29. Even in its second submission, the complainant has failed to state a *prima facie case* of an infringement of the competition rules. Consequently, the complaint should be rejected, and the Commission should advise the complainant thereof in accordance with Article 6 of Regulation N° 2842/98.

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[50] Examples: It is widely known in musical circles that it took "The Beatles" not more than about 10 minutes to write their most successful work: "Yesterday". By contrast, it took a famous French creator, Jacques Demarny one and a half years to write his most successful work: "Les gens du Nord".

C. Legal Observations

I. Lack of Community Interest

30. The complainant disregards the possibilities of judicial protection which national courts and authorities offer.[51] In addition, the complainant overlooks[52] the recent changes in Community competition law. Article 6 of Regulation N° 1/2003 confirms that, as of the coming into force of that Regulation in May 2004, every national court and every competition authority in the Community will have power to assess a practice under the European Community rules.[53]

31. The Court of Justice has also recognised the competence of national authorities to decide whether a royalty rate for copyright was equitable or abusive[54].

32. Indeed, national laws often provide special procedures to determine the adequacy of royalties. This is the case for German law[55], for the United Kingdom, Ireland and for the Swiss arbitration system.

33. National courts have already determined, in the cases before them, what constituted an equitable remuneration. For example, the Munich Courts of Appeal *("Oberlandesgericht München")* has recently held that it was not appropriate to determine the royalty on the basis of the profit of the record producer. Furthermore, it stated that:

> *"Diese Anknüpfung am Umsatz folgt aus der Notwendigkeit, den Urheber* ***nicht*** *auf eine Position zurückzudrängen, die ihn* ***am wirtschaftlichen Risiko des Nutzers*** *beteiligen würde"*. (Emphasis added)

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51 Cf. points 116 et seq. of the response.

52 See Universal's second submission, part C, p. 38, point 63.

53 See Universal's second submission, part C, p. 37, point 61.

54 See Case 395/87 *Ministère Public v Jean Louis Tournier* [1989]2521 at paras. 25, 26 and 32.

55 Under the German *"Urheberrechtswahrnehmungsgesetz"* (Copyright Administration Act), the Arbitration Body of the German Patent and Trademark Office, and on appeal the German courts, can determine the reasonableness of the conditions and of the royalty rates; see also footnote 74 of the response. It is in this framework that the decision of the Munich Court of Appeals has been rendered.

> *"This reference to turnover follows the need **not** to push the author into a position where he would be **sharing the economic risk of the user**."* [56] (unofficial translation, emphasis added).

II. No Breach of Article 81 (1) EC

34. We continue to rely on the Commission's comfort letter dated 4 December 2000.[57] Before it issued this comfort letter, the Commission also reviewed the Standard Agreement in its latest version (Amendment No 7 of 1998).[58] This version is still applicable today.

35. The complainant has failed to state facts unknown to the Commission at the time of the comfort letter and which might justify a reconsideration of the comfort letter. Therefore, in our view, all issues under Article 81 (1) EC relating to the BIEM Statutes or to the Standard Agreement are settled.[59]

36. According to the comfort letter, there is no problem under the first paragraph of 81 EC. It is therefore irrelevant that the complainant relies on cases where exemptions under Article 81 (3) EC had been at issue.[60]

37. We find it astonishing how lightly the complainant discards the legal authority of the comfort letter.[61] We refer to **Annex 2** to the response which shows the scope and the quality of information on which the Commission had based its comfort letter. In the meantime, Commissioner Monti has confirmed on behalf of the Commission that the activities of collective management societies do not pose a problem under Article 81

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56 See Judgement of 12 June 2003, Case 6 WG 4/00, IFPI / GEMA, page 30, not yet published.

57 See response, point 34.

58 See, in particular, **Annex 2** to the response and complaint, p. 8, point 1.6;

59 See the case law cited in footnote 78 of the response.

60 These irrelevant cases are the *Net Book Agreements* matter, finally decided in Case-360/92 P *The Publishers Association v Commission* [1995] ECR I-23, paras. 35 seq. on the grounds of insufficient reasoning (Article 253 EC) in relation to Article 81 (3) EC, and the *Visa* matter, disposed of by way of an exemption under Article 81 (3) EC, Case No COMP / 29.373 – Visa International, OJ L 293/24 of 10 November 2001, both cited in Universal's second submission, part A, p. 15 and 16, points 2.4 and 2.5.

61 See Universal's second submission, part C, p. 39, point 5.

(1) EC.[62] Commissioner Monti in turn relied on the jurisprudence of the Court of Justice in *Tournier* and *Lucazeau*.[63]

38. The complainant argues that BIEM is trying to impose the provisions of the Standard Contract on IFPI and is not willing to negotiate.[64] As stated above, this is not true. BIEM is willing to negotiate the terms of the Standard Contract. However, BIEM is unwilling to make unilateral concessions without receiving any equivalent counter-concessions by the Record Producers. The alleged statement by *Mr. Cees Vervoord* "There will be no change to the Standard Contract at all"[65] is taken out of context. It was related to a proposal from IFPI. This proposal did not provide any trade-offs for BIEM and its Member Societies, for example a reduction of the packaging deduction.

39. Good business practice (no unilateral imposition by BIEM as alleged by the complainant) is illuminated by the following: BIEM and IFPI freely negotiated and concluded on November 26, 2002 a deal for Bulgaria which, taking into account the very high level of piracy in this country includes all the terms of the Standard Agreement and in particular the Standard Rate of 9.009%, as well as a contribution by the Bulgarian Authors' Society to a jointly administered anti-piracy fund. Universal's Vice President for Eastern Europe participated in those negotiations. IFPI members in Bulgaria had manufactured and sold records for many years without any payment to creators at all.

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62 See above at para. 3.

63 Answer on behalf of the Commission dated 9 December 2002 to written question P-3217/02 by *Arlene McCarthy*, OJ C 242 E/49 of 9 October 2003. See also, for a similar conclusion, § 30 of the German Antitrust Act (*"Gesetz gegen Wettbewerbsbeschränkungen"*), which exempts the activities of copyright management societies from the rules on consensual antitrust behavior; See case 395/87, Ministère public v. Jean-Louis Tournier, [1989] ECR 2521; joined Cases 110/88, 241/88 and 242/88 *François Lucazeau v SACEM* [1989] ECR 2811.

64 See Universal's second submission, part C, page 19, point 29.

65 See Universal's second submission, part C, page 19, point 29.

III. No Breach of Article 82 EC

40. The complainant's allegations concerning "abuse" are no less verifiable than in the complaint. We address this by rejoining, by and large, in the order of our response. We would like to highlight two points:

(1) The complainant has failed to provide evidence for an imposition of unfair trading conditions, as required by the Court in *Tournier*.[66]

(2) The complainant relies on "inefficiencies" to which, in its opinion, the Four Points lead. This "inefficiency" approach follows from United States antitrust thinking which has guided very obviously Mr. Ordover. However, the US approach clashes with the test of "abuse", which is central to the Community competition rules. As a consequence, the complainant discusses another issue ("inefficiencies") than the one it has raised itself ("abuse"). As we shall elaborate, we contend that mere inefficiencies are irrelevant under the Community competition law on "abuse". Nevertheless, we shall prove that the complainant's inefficiency claim, even if it were relevant, is devoid of any basis. We will revert to this below at para. 84 et seq.

1. Burden on the Complainant to Prove "Abuse"

41. It is exclusively for the complainant alone to state a *prima facie* case of an "abuse", which might justify an investigation by the Commission. An "abuse" can only be derived from concrete circumstances attributable to BIEM or BIEM Member Societies that (1) conflict with the objectives of the Treaty[67] and (2) influence the

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66 Case 395/87 *Ministère Public v Tournier* [1989] ECR 2521, para. 34.

67 See response, point 172.

structure of the relevant market.[68] Commercial difficulties or "inefficiencies", even if proved *(quod non)*, do not as such indicate an "abuse".[69]

42. Current collective licensing does not negatively influence the market structure. Quite the contrary, it ensures non-discriminatory access of all Record Producers to the markets for the manufacture and distribution of sound carriers. [70] It stimulates market entry and increases the number of players on the market. For smaller Record Producers, non-discriminatory licensing conditions and collective licensing are the only way to overcome barriers to entry.

43. Point 1.10 of Universal's second submission makes it necessary to correct a fundamental misunderstanding of the complainant: *Article 82 EC is not a toolbox for licensees who, like the complainant, feel dissatisfied with the amount of royalties to which they agreed.* As a rule, even a dominant licensor remains free in its negotiations; as long as it does not force the licensee to accept non-equitable conditions as they are defined in Article 82 EC.

44. As a result, the complainant has been unable to show a prima facie case for "abuse". None of the objectives of the Treaty are affected by the activities of BIEM or its Member Societies. The complainant has not proved that the structure of the market has been altered on account of these activities. There is no refusal to supply or to negotiate, or any attempt to partition the Common Market which would restrict the freedom to provide services or to supply goods. In the absence of such restrictions, *the complainant is unable to cite <u>concrete</u> examples from its own business practice, which*

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68 <u>See</u> Case T-128/98 *Aéroports de Paris v Commission* [2000] ECR II-3929, para. 170 relying on Case 85/76 *Hoffmann–La Roche v Commission* [1979] ECR 461, para. 91: "The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market …".

69 <u>See</u> response, point 86: Mere commercial difficulties … do not constitute a reason to challenge an agreement…"

70 Admitted in Universal's second submission, part A, p. 10, point 1.10.

would show that the Four Points produce an anti-competitive outcome[71]*, as alleged by the complainant.*[72]

2. No Obligation for Creators to Share Risks of the Record Producers

45. We have given a full account of BIEM's flexibility, and of the resulting concessions by BIEM vis-à-vis IFPI.[73] These concessions were consecutive and substantial. Nevertheless, the complainant claims that BIEM's members and the BIEM Standard Rate are insulated, and are disconnected or divorced from market realities.[74] We recall that the history of royalties has been one of concessions by the creators, each of which took account of alleged "market realities"[75]. In the present case, the negotiated results have reached a point where BIEM has the right to draw a line in the sand.[76] BIEM's mission is to ensure an appropriate income to creators. In the interest of the creators, BIEM should not be forced into the position where it has to make any and all of the concessions that the complainant expects.

46. Even dominant undertakings are entitled to protect their own commercial interests when they are attacked.[77] Therefore, the BIEM Member Societies may, without committing an "abuse" within Article 82 EC, negotiate royalties independently,

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71 See Universal's second submission, part A, p. 10, point 1.10.

72 As we have said above at para. 4 section (3), it is astonishing that the complainant does not draw on its centralized and comprehensive marketing data in order to state its case. Apparently, the figures from the "real life" do not justify the complainant's case.

73 See response, points 61 to 70.

74 See Universal's second submission, part A, p. 5 and 6, points 1, 1.1 and 1.4, p. 8, point 1.7 and p. 15, point 2.3.

75 See response, points 61 to 70,

76 Mr. Ordover opines in point 56 of his report that since BIEM has agreed that deductions from the basic rate follow discounts to a defined and fixed extent, such deductions should follow discounts to *any* extent. This is an unworldly fallacy. It is common sense for BIEM (like any operator) to draw a bottom line ("this far and no farther") when it enters into price (or rebate) negotiations.

77 See Case T-139/98 *AAMS v. Commission* [2001] ECR II-3413, para. 79. By limiting our argument to the requirement of an "abuse" within Article 82 EC, we do not admit that the further requirements set out in Article 82 EC – and, in particular – the requirement of dominance are met; see response, point 134.

subject only to their internal regulations and to democratic control by creators.[78] This does not constitute an "abuse" within the meaning of Article 82 EC. It is settled Community law that the specific subject matter of intellectual property rights must by all means be protected, also within the application of Article 82 EC.

47. The complainant acknowledged that "Record companies are paying lower standard rates than previously".[79] In addition, BIEM has agreed to a deduction for packaging rates (10% of 11% of the PPD) – a deduction that is without economic counter-value. Even IFPI acknowledged that the packaging deduction was too high. [80]

48. Contrary to the complainant's view, *BIEM does adapt its negotiation positions to market developments.* The question is only how far BIEM should go. We reiterate that this question is one of market assessment on a case-by-case basis.

49. The complainant asserts "imbalances" in favour of the creators and to the detriment of Record Producers, "a shift in the relative risks and returns", and a "change in the overall condition of the market for recorded music".[81] However, the complainant does not present any evidence. As the NERA study shows, creators bear a much higher risk than the record producer.[82] The complainant's assertion is nothing but *a new way of saying that the complainant wishes to shift income from the creators to the Record*

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78 See [1978] ECJ 1139 *Hoffmann - La Roche v. Centrafarm* para. 16; see also Case 102/77 *Parke-Davis / Probel* [1968] ECR 85, summary, paras. 2 and 3: The existence of the rights granted by a Member State to the holder of a patent is not affected by the prohibitions contained in Articles 85 (1) and 86 of the Treaty. The exercise of such rights cannot of itself fall either under Article 85 (1), in the absence of any agreement, decision or concerted practice prohibited by this provision, or under Article 86, in the absence of any abuse of a dominant position. A higher sales price for the patented product as compared with that of the unpatented product coming from another Member State does not necessarily constitute an abuse of a dominant position.

79 See complaint, point 5.15.

80 Mr. David Fine, Chairman of the Board of the IFPI Secretariat, in a letter dated 20 July 1992 wrote to Jean-Loup Tournier, the then president of BIEM: The average packaging costs as a percentage of the PPD (1990-1991) for a CD were 8.1%. Since then, the packaging costs have been reduced even further. In a letter dated 29 November 1996 to Mr. Ronald Mooij, Mr. David Sweeney, Senior Legal Adviser of the IFPI Secretariat, stated that an external consultant of IFPI had estimated the packaging costs from data supplied by individual record companies. A total of 25 record companies had been surveyed. The average packaging costs were "calculated as a percentage of net sales (ARP) [...] by weighing each territory in proportion to sales reported for these territories using IFPI statistics." The calculation resulted in packaging costs for a CD of 7.4%.

81 See Universal's second submission, part A, p. 6, point 1.3.

82 See sections 2 and 3.2 of the NERA study, **Annex 11**.

Producers. The complainant talks of the many discounts and rebates it is giving to retailers but provides no details to substantiate them. Many of these concessions to retailers are solely for the benefit of the record producers – such as early payment rebates. Other discounts may be given in return for which the retailers take on some of the costs which are the responsibility of the producers – such as a discount in return for the retailer paying for an advertising campaign (known as "co-op advertising"), or a discount in return for a retail chain agreeing to take on part of the costs of distributing records to its affiliated stores. Discounts such as these are nothing more than cost shifting exercises by the producers.

50. *It does not constitute an "abuse" if BIEM refuses to adapt royalties to each price deduction that Record Producers in their sole discretion grant their customers.*[83] Yet, that is the basic contention of the complainant. If this contention were realized, it would lead to a full integration of the creators' business into the Record Producers' business.

51. No rule of Community law requires creators to share losses resulting from the risk business of the Record Producers (discounting, high volumes, inflation of the market share).

52. *A fortiori*, it does not constitute an "abuse" for BIEM or BIEM Member Societies to *limit* the extent to which they allow royalties to follow marketing or pricing decisions by the Record Producers. If such a limitation could constitute an abuse (*quod non*), then the Commission would be confronted with delicate questions of price regulation: *How should the Commission draw a bright line between abusive and non-abusive limitations of a linkage between royalties, on the one hand, and prices that Record Producers charge to their customers, on the other hand?*

53. That leads us back to the basic conclusion: Only the PPD is the proper basis for the calculation of royalties. This is confirmed by the NERA study.[84] The Commission has requested use of the PPD as basis for the calculation of royalties.[85]

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83 See response, points 150 and 151.

84 See section 5 of the NERA study, **Annex 11**.

54. We conclude that the complainant's theory of "abuse" [86] is deprived of any basis. We are not aware of any rule of law according to which it would be "abusive" for a licensor to refuse to allow the royalty for its licence to follow strictly the profit that the licensee earns by exploiting the licensed right. [87]

55. The complainant argues, again, that the Standard Agreement does not take account of "market realities". We can only repeat how flexibly BIEM has reacted to these realities: There is a deduction for packaging which amounts to 10% of the 11% rate and leads to 9,9% of the PPD. There is a flat deduction for discounts, which is 9% of 9,9% of the PPD.[88] This leads to a rate of 9,009%. However, it is a question of freedom to conduct business (Article 16 of the Charter of Fundamental Rights) *to what degree* BIEM and its Member Societies make concessions.

56. Universal's second submission provokes two final observations:

(1) BIEM has never suggested that Record Producers should limit competition with other Record Producers, or interfere with retail prices.[89] The contrary is true: BIEM ensures access to licences by all Record Producers, and it grants such access on non-discriminatory terms. This is indispensable for Record Producers to compete among themselves in a level-playing field.

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85 See response, point 57, footnote 34. The Commission's motive was to achieve greater transparency. The Commission reaffirmed this position in its draft statement of objections, at para. 37 in Case N° COMP/M.1852 – *Time Warner / EMI*.

86 See complaint, p. 10, point 1.10, end of 3rd bullet point: "… 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." Complaint, p. 24, point 4.9: "… record companies should not pay royalties on money they do not receive." Complaint, p. 36, point 5.13: "… the BIEM Standard Rate should only be paid on the price actually received for the product." Complaint, p. 38, point 5.14: "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." Complaint, p. 43, point 5.24: "The value of the composer's mechanical rights depends on the profit that the user of the right can make from it." (that is: no intrinsic value). Complaint, p. 48, point 5.35: "BIEM is effectively dictating, from a position of dominance, how Universal, in a position of dependence, should run its business."

87 See, for clear decisions to the contrary, the decisions of the German Supreme Court ("*Bundesgerichtshof*") cited in point 220, footnote 145 of the response and of the Munich Court of Appeals (*Oberlandesgericht München*), above at footnote 14.

88 See response, point 61 (1) and (4).

89 See Universal's second submission, part A, p. 8, point 1.7.

(2) BIEM expects Record Producers to honour and fulfil licensing agreements that Record Producers have concluded with BIEM Member Societies in accordance with the Standard Agreement.[90] Neither BIEM nor its Member Societies infringe competition law if they expect payment of a royalty as agreed in the relevant licensing agreements.

3. Acceptance of the Four Points by Way of Contractual Negotiations

57. IFPI has accepted the Four Points by way of an arms-length agreement: the latest version of the Standard Agreement, that of 1998[91], which is still applied today.

58. In point 146 of the response, we asked the complainant *what circumstances may have arisen between 1998 and 2002 that, in the complainant's view, have turned the Four Points from a negotiated and fair solution in 1998 to an "abuse" within the meaning of Article 82 EC in 2002.* It emerges from Universal's second submission that the complainant is unable to answer this question. The complainant leaves the reader with unverifiable vaguenesses – without examples from its business practice that would illustrate its alleged grievance and without concrete business data.[92]

4. The Allegation of Unilateral Dependence of Record Producers on Creators: A Fundamental Flaw

59. It must not be forgotten that the collecting societies stand as proxy for their members, the creators. The societies' mission is to make a collective effort to ensure an

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90 See response, point 168.

91 **Annex 3** to the response.

92 See, e.g., Universal's second submission, part A, p. 3, 2nd bullet point: "The discount structures within the Standard Contract are fixed without reference to market conditions which are now out of date …"

appropriate income for creative persons.[93] The societies are not integrated into large conglomerates. They are not-for-profit organizations, unlike the complainant.[94]

60. The complainant lacks clarity when it speaks about "imbalances".[95] Creators critically depend on Record Producers for their income. Record Producers are an important outlet for creators' work. Without Record Producers, most creators would not get very far. One needs the other.

61. Creators rather than Record Producers have to bear the two heaviest of all risks: (1) that of innovation (creation of new works), and (2) that of marketability of the works to which innovation leads.[96] Most creators compose music without knowing whether it will ever be marketed, and, if so, on what terms, and with what resulting income.[97] The NERA study concludes:

> "Most individual creators 'do not make it' and earn royalty payments well below the average minimal wage. […] Furthermore, there is very limited evidence of upwards rights—related revenue mobility across periods […].
>
> The risk of composing is thus materialized by a very low ex ante probability of eventually entering the small number of composers whose works sell well enough to ensure them a decent living." [98]

By contrast, Record Producers can select from millions of already composed pieces of music that are available for licensing. *The risk of Record Producers is lower than the risk of creators because Record Producers enter the market at a stage where the break-through innovation, that is: the song, has already been made, and where Record Producers have a wide choice among creations.* The NERA study

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93 See at para. 45 of the present rejoinder.

94 See response, point 30.

95 See, e.g., Ordover report, p. 6 seq., point 8.

96 See section 2 of the NERA study, **Annex 11**.

97 Admitted in point 28, footnote 27 of the Ordover report: "Composers who do not perform bear the risk that the composition may never be recorded and performed and thus will yield no income." However, the Ordover report grossly over-generalizes in point 31, footnote 31, according to which composers depend less on the sale of sound carriers than Record Producers.

98 NERA study at section 2.4, page 15 et seq., **Annex 11**.

demonstrates the risk-pooling[99] and other risk mitigating[100] techniques of the record companies.

62. All the Majors can rely on mixed profit calculations. By contrast, composers cannot rely on mixed profit calculations because they have nothing but their music-creating talent. Risks and returns are turned upside down when Mr. Ordover contends:

> "The magnitude of the record company's investments certainly dwarfs the opportunity costs of the composer's time."[101]

63. As a result, there is no "imbalance". In the absence thereof, negotiated terms (such as the Four Points) must be assumed to be "reasonable" and outside the notion of "abuse".

5. No Disproportion or Excessive Royalty Disparities

64. Contrary to the complainant, the Common Market is the only proper basis for price comparisons. The *Tournier* judgment in its paragraph 38 states that price differences as such are not conclusive of an "abuse" within Article 82 EC unless three conditions are fulfilled:

(1) The price differential must exist between Member States of the Community – and not between Member States and third countries.

(2) The comparison of the fee levels must have been made on a consistent basis.

(3) The price differentials must be appreciably high. In the Commission's opinion, the challenged prices must be "many times higher" than the prices compared.[102] [103]

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99 See section 2.2 of the NERA study, **Annex 11**.

100 See section 2.5 of the NERA study, **Annex 11**.

101 Point 33 of the Ordover study.

102 The relevant passage is cited in point 180 of the response: "When an undertaking holding a dominant position imposes scales of fees for its services which are appreciably higher than those charged *in other*

65. Even where these three requirements are fulfilled – which is not the case here – there is only an "indication" of an abuse. This indication can always be rebutted by the relevant rightsholders.

a) The Limitation of Comparisons to the European Community

66. The underlying policy of the three *Tournier* requirements is simple: The task of the Community is to establish "a system ensuring that competition in the internal market is not distorted".[104] Accordingly, Article 82 EC is concerned only with anti-competitive effects on "trade *between Member States*" (emphasis added) – rather than with effects on trade with third countries. Community competition policy has never aimed at blindly copying third country market conditions, such as those invoked by the complainant. Community competition policy is unique.

67. The complainant nevertheless suggests price comparisons on a worldwide basis as a yardstick to determine "abuse".[105] However, the complainant has no legal or policy argument which would justify it to transcend the Community context, and to extend comparisons to third countries. The objectives of Community competition law do not force Community operators always to charge the cheapest of all prices that are practised somewhere around the globe ("race to the bottom"). Commissioner Monti has confirmed this view: Price differentials are only relevant if they occur within the EU (or within the internal market).[106]

Member States and where a comparison of the fee levels has been made *on a consistent basis*, that difference must be regarded as indicative of an abuse of a dominant position. …" (emphasis added)

103 See § 37 of the *Tournier* judgment.

104 See Article 2 and Article 3 lit. g EG (emphasis added).

105 See complaint, top of page 8, point 1.5: „taking full account of current market condition comparables elsewhere in the world." "it is legitimate to look at comparables elsewhere in the world". See also complaint, p. 9, point 1.9: "there are no objective, relevant dissimilarities, or any other reasonable grounds…" and Ordover report, p. 5, point 6.

106 See answer on behalf of the Commission dated 9 December 2002 to written question N° P-3217/02 by *Arlene McCarthy*, OJ 242 E/49 of 9 October 2003. The Commissioner relies on the Court's jurisprudence in *Lucazeau* and *Tournier*.

b) Lack of a Common Denominator (or of a *"tertium comparationis"*)

68. The complainant states that "exactly the same rights"[107] are considered in all countries. However, this does not mean that comparisons with all third country markets in the world are valid. A comparison is only valid where there is a common denominator or a *"tertium comparationis"*. In the present case, that *"tertium comparationis" requires a legal and economic environment that is sufficiently similar to that of the Community.*[108] The complainant has not shown that legal and economic environments in the third countries, on which it relies, are sufficiently similar to the Community.

69. BIEM believes that this is not possible, for two reasons:

70. *Firstly, the BIEM rate is the only rate in the world that is set by way of free negotiations between equal partners* – BIEM and IFPI. By contrast, Australia and the United States have compulsory schemes. In those countries rightsholders cannot disapprove mechanical reproduction of their creations if only the Record Producer complies with the compulsory scheme. The United Kingdom has a Copyright Tribunal, which determines rates and whose determinations are binding. The United States has a "penny rate", whereby Record Producers can exercise superior bargaining power to force creators to take less.[109] [110] [111] There is no competitive environment (although the complainant itself says that such an environment is "essential" in order to make valid comparisons[112]). In Japan the rate and conditions are subject to regulatory overview. The Japanese system is not based on the PPD. It took the

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107 See Universal's second submission, part A, p. 17, point 3.1, third sentence before footnote 34.

108 The complainant itself acknowledges that comparisons can only be made with "broadly comparable territories"; see Universal's second submission, part A, p. 14, before footnote 34.

109 It is worth noting in this context that Universal appears to have misrepresented the situation regarding controlled composition clauses in the US. Universal claims that "legislation in the mid-1990's prohibited reduced rates for controlled compositions for recordings made after 22 June 1995." See Part C, page 3. However, we have evidence that Universal continues to apply reduced rates for controlled compositions and still insists on controlled composition clauses in new artist contracts. Upon request, we will provide the Commission with the relevant evidence as a business secret.

110 See point 190 of, and **annex 10**, to the response.

111 The complainant requested to treat its comparison of royalties in the Community and in the United States as a business secret (see **Annex 3** to the complaint). We are therefore unable to comment on this comparison.

112 See Universal's second submission, part A, p, 17, point 3.1, last sentence.

complainant some difficulty to convert Japanese royalties from "the real life" to fictitious Japanese royalties based on a PPD.[113] In South East Asia, piracy is rampant, and there is no historical culture of paying royalties for the use of authors' rights. The major Record Producers and their affiliated music publishing companies have an arrangement between themselves for paying mechanical royalties to each other, although the negotiations are not at "arms length" as the persons representing the publishers are often employees of the Record Producers. In Russia, creators, despite best efforts, do not, as far as we are aware, receive payment from the complainant or other IFPI members at all.

71. *Secondly*, it is a common tradition of the Member States to recognise and protect intellectual property, including authors' rights, in order to ensure authors a fair remuneration for their creations.[114] It is a tradition of the Community to protect and foster cultural diversity (Article 151 EG, in particular paragraph 4 thereof and Article 3 lit. q EC). As we have concluded in our response[115], cheaper royalties, blindly copied from third countries, obtained by a forced reduction of creators' income, have a cultural price: the incentive to invest in creation by publishers will diminish and as a result fewer songs and other pieces of music will appear.

72. If the Commission were to consider comparisons with third country markets, we recall that BIEM has asked to be advised thereof beforehand.[116] Without notification by the Commission, BIEM would not be able to exercise its rights of defense, for example by being heard on price differentials that might occur on a worldwide scale.

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113 See footnote 75 in **Annex 3** to the complaint.

114 We refer, to the speech by *Dr. Herbert Ungerer*, application of competition law to rights management in the music market – some orientations, speech of June 11, 2003 before the Independent Music Companies Association (IMPALA).

115 See response, points 198 to 202.

116 See response, point 183, footnote 118.

6. The Irrelevance of the Inefficiency Claim

a) Irrelevance as a Matter of Law

73. Mere "inefficiency" – which is the pivotal point of Universal's second submission and the Ordover report - cannot be equated with an "abuse" within the meaning of Article 82 EC. Where an undertaking is dominant, not all conduct by that undertaking is abusive only because one might imagine alternative conduct by that same undertaking that might have led to greater efficiency. Article 82 EC is limited to a prohibition of "abuses" of a dominant position. If mere inefficiencies could constitute abuse, each move of the dominant enterprise would first have to be examined, from the angle of economics, whether it was optimally efficient or not.

74. Mr. Ordover contends that lower rates will lead to higher profits for both Record Producers and creators ("efficiency"). This contention is based on speculation alone, not on evidence.

75. Even if the complainant *had* proved an opportunity to enhance "efficiency" (*quod non*), failure to realize such a chance would not indicate an "abuse". Under the freedom to conduct a business (Article 16 of the Charter of Fundamental Rights) and in the absence of specific circumstances, it is not an "abuse" if a dominant undertaking takes one commercial decision that appears less "efficient" than another. *Economic desirability (e.g. enhanced efficiency), on the one hand, and an infringement of the competition rules, on the other hand, are different things.*

76. Where there are no specific circumstances relating to the *structure* of the relevant market and competition in that market[117], a dominant enterprise remains free to take those decisions that it deems suitable, without exposing itself to a verdict of "abuse". As the Court of First Instance has stated:

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[117] See Case 85/76 *Hoffmann–La Roche v. Commission* [1979] ECR 491, para. 91; discussed above at para. 41 and 67 of the present rejoinder.

> "the fact that an undertaking has a dominant position does not deprive it of its entitlement to protect its own commercial interest …"[118]

Thus, even if BIEM or its members were "dominant"[119], they would not be restricted in their reasonable pursuit of the interests of creators.

77. The simplistic "efficiency test", on which the complainant and Mr. Ordover rely, is alien to European competition analysis under Article 82 EC. Mr. Ordover is influenced by United States antitrust law and, more particularly, by the United States Intellectual Property Guidelines (http://www.usdoj.gov/atr/public/guidelines/ipguide.htm). These Guidelines state in paragraph 3.4:

> "To determine whether a particular restraint in a licensing arrangement is given per se or rule of reason treatment, the Agencies will assess whether the restraint in question can be expected to contribute to an efficiency-enhancing integration of economic activity. See Broadcast Music, 441 U.S. at 16 – 24" (emphasis added)[120]

78. This test is at odds with the rules and policies established under Community competition law: Community competition law does not provide for any "rule of reason" within the framework of Article 82 EC.[121] This "rule of reason" is the backbone of Mr. Ordover's inefficiency claims and of the United States rules, on which Mr. Ordover relies. The test in the Community is whether, as a result of the licensing practice under consideration, the *structure* of the market is influenced and, because of that, the degree of competition is weakened. This follows from the *Hoffmann-La Roche* judgment of the Court.[122] One of the conditions of Article 82 EC is that the abuse must be the cause for the change in the market structure.

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118 Case T-139/98 *AAMS v Commission* [2001] ECR II-3413, para. 79; same statement in Case T-65/89 *BPB Industries and British Gypsum v Commission* [1993] ECR II-389, para. 69, upheld on appeal, Case C-310/93 P [1995] ECR I-865.

119 We did not accept that BIEM or its members were dominant; see response, point 134.

120 For the difference between the European School and the United States "efficiency approach" see generally *Hildebrand*, The Role of Economic Analysis in the EC Competition Rules – The European School, 2nd ed. 2002, p. 147 seq., Chapter III, point 6.1 ("The Efficiency Doctrine").

121 See Case T-112/99 *M6 and others v Commission* [2001] ECR II-2459, paras. 104 to 106, 108 and 109 (with respect to Article 81 [1] EC); incorrect, therefore, point 5.4 of the complaint.

122 See Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, para. 91. See also Office of Fair Trading, Innovation and Competition Policy, March 2002, p. 92, para. 68: "When assessing the

79. Even if "efficiency" were a factor for assessing "abuse", the burden of demonstrating lost efficiency gains would lie exclusively with the party forecasting those gains, that is to say, on the complainant. The NERA study shows that the complainant and its economic expert have not proven any link between the continued application of the Four Points on the one hand, and any harm to consumers, on the other hand.[123]

80. The complainant tries to substantiate its claim of excessive royalties by quoting from an article by *Mr. Temple Lang* about royalty rates.[124] We agree that a single rate is a warranty against discriminations and provides phonogram producers an equal access to the market.

81. The complainant omits other parts of *Mr. Temple Lang's* article which are relevant to the allocation of risks in the music industry. *Mr. Temple Lang* states that:

> *"Sound recording companies take modest risks when they first produce any recordings, as the recording may not be a success. But they take no risks when they license the performance of works in which they own the copyright or performing rights, and they have none of the risks which are run by individual composers or musicians [...] who have invested years in practice and training and who run the risk of illness or change of taste or fashion."*[125]

Universal also omits to mention that according to *Mr. Temple Lang*:

> *"Regulatory approval would be evidence against excessive prices…"*[126]

82. In line with that statement, the numerous regulatory approvals of the BIEM Standard Agreement provide evidence against the allegation of excessive prices. By way of example, we refer to:

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competitive effects of licensing practices the relevant issue, from an economic perspective, is whether the licence or condition in question will make the market more or less competitive compared to the likely alternative outcome if the licensing practice is proscribed."

123 See sections 4.1., 5.2.2. and 6 of the NERA study, **Annex 11**.

124 See Universal's second submission, part C, page 6, point 5.

125 See *John Temple Lang*, Media, Multimedia and European Community Antitrust Law, page 55, at the end of the 1st paragraph, sub (8).

126 *John Temple Lang, id.*, page 57, 3rd paragraph, sub (14).

? the fact that the European Commission has looked at the BIEM Standard Contract on numerous occasions and requested detailed changes which have been incorporated in the current version of the Standard Contract.

? the aforementioned judgement of the Munich Court of Appeals (*"Oberlandesgericht München"*) dated 12 June 2003 in Case 6 WG 4/00 approving the German tariff and rejecting the application of IFPI for a special deduction (not yet published); [127]

? the decisions of the Swiss Confederate Arbitration Committee for the Exploitation of Copyrights and Similar Protective Rights (*"Eidgenössische Schiedskommission für die Verwertung von Urheberrechten und verwandten Schutzrechten"*) of 4 November 1997, 27 October 1998, 13 December 1998 and 1 November 2000;[128]

83. The complainant has been unable to cite one decision against the royalty rate set by the Standard Contract by any of the numerous regulatory bodies, which exist at Member State or third country level (e.g., France, Germany, Switzerland, United Kingdom) and which have dealt with the proper amount of royalties for decades.[129]

b) Lower Royalties Do Not Increase Welfare "For All Concerned"

84. This section is submitted only in case the Commission – despite all the foregoing – takes the view that conduct by BIEM or its members leads to "inefficiencies" and that these "inefficiencies" may be relevant for assessing whether or not there is an "abuse" within the meaning of Article 82 EC. We submit that even in that case, there would be

127 Upon request, we shall provide copies of this decision to the Commission.

128 Upon request, we shall provide copies of these decisions to the Commission.

129 The UK Copyright Tribunal decision to which the complainant refers concerned a new and higher royalty rate of 8.5%. It was a decision away from the older and lower UK tariff which had been 8.2% of the PPD. The decision was mainly based on specificities of the UK market.

no abuse since Record Producers are most likely to *pocket* additional profits, *rather than sharing* such profits with creators or consumers.

85. The complainant presents a surprising theory in point 1.15 of part A of Universal's second submission. For the complainant, there is an "*identity of interest between recording companies and collecting societies*" to achieve "greater total revenue from royalties for creators".[130]

86. Already at first glance, this surprising theory goes against common sense: If it were true, then Record Producers would immediately lower their PPD in order to offer phonograms at a lower price and to pay less royalties.[131] To our knowledge, Record Producers have never done this in Europe.

87. In addition, the complainant and its economic expert have not proved the four causal links mentioned above[132], in particular the following causal links between:

(1) lower royalties and lower consumer prices[133] [134]; and

(2) lower consumer prices and higher income for creators.

88. Concerning (1), we presented empirical evidence to the effect that there is no causal link between lower royalties and lower consumer prices.[135] Royalties have no

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130 The complainant wishes to appear as a "benefactor" for all. See, e.g. Universal's second submission, part C, p. 29, point 44: "Universal's primary concern is to provide products that will improve consumer welfare, in other words to provide products that will sell in large numbers and thereby benefit Universal, *the creators* and consumers." (emphasis added). See also Universal's second submission, part C, p. 31, point 48. This altruism appears strange. A for-profit business like Universal is only interested in one thing: to maximise its own profits.

131 See Universal's second submission, part A, p. 13, point 1.17: "… a reduction in price and therefore a boost to sales could, in principle, always be achieved by a reduction in the PPD."

132 See above at para. 4 Section (1).

133 See response, point 205. As the British Copyright Tribunal has rightly pointed out: "The final price of records will be influenced by many other factors before they reach the market."

134 See response, point 85, with explanations of the real factors that lead to consumer prices.

135 See point 88 and **Annex 5** of BIEM's response (no empirical interrelation between royalties and retail prices).

interrelation with consumer prices: *Consumer prices may go up even though royalties decrease*.

89. Concerning (2), the complainant and its economic expert have not submitted the slightest proof of a causal link between lower consumer prices and higher income for creators. Even if Record Producers realized higher profits through lower consumer prices, Record Producers would pocket these higher profits and not share them with creators. For a creator's income to increase, volumes would have to increase to such an extent that despite the lower royalty the creator would overall earn more (because of the aggregate of royalties due to him). The complainant and its economic expert have not presented any "real life" example where this would have been the case, or might be the case in the future. In addition, the NERA study demonstrates that reduced royalty rates and the removal of the minimum royalty and maximum track provisions would hurt the creators community instead of providing a higher income.[136]

90. Remarkably, in point 1.9 of part A of Universal's second submission, the complainant admits that there is no causal link between royalties and consumer prices. The complainant confirms that in respect of one and the same product, there is no correlation between pricing decisions by the Record Producers, on the one hand, and retail prices for consumers, on the other hand ("no consistent correlation between low PPD and low retail price"). If, however, there is no such correlation, how then can the complainant go on to claim that price concessions by BIEM vis-à-vis the Record Producers, and price concessions by the Record Producers vis-à-vis their own clients, which in the complainant's view, would lead to lower retail prices for consumers? *The complainant has admitted that lower royalties would not lead to lower consumer prices.* It should be noted, in this context, that Record Producers cannot influence consumer prices. The consumer prices are set by the retailers alone. It would be a violation of the competition rules if Record Producers attempted to oblige retailers to charge certain fixed prices at the retail level.

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136 See sections 4 and 6 of the NERA study, **Annex 11**.

91. In truth, consumer prices of sound-carriers are hardly ever affected by production costs in general and by the level of royalties in particular. Even though we are not obliged to provide any evidence, we shall substantiate this point further with economic evidence and statements by the Majors themselves:

92. The independence of consumer prices from the royalty rate can be explained mainly by:

? the structure of the market of sound-carriers, which is an oligopolistic market, where competition among Record Producers is not based on prices;

? the unsubstitutability of each title (catalogue number) which determines inelasticity on the demand side. In other words: consumers' choices are not driven by prices.

93. These characteristics of the market were admitted by the Majors themselves. The Majors tried to explain the lack of price competition between them during the investigation by the Italian Competition and Market Supervisory Authority (which resulted in a decision of that Authority dated 9 October 1997[137]). There, the Majors said that:

> *"….. in such a characterized market, the **main factor of competition** between the producers consists of the **public success of the artists** with which each of them has an exclusive contract for execution of performances and for the reproduction of phonographic carriers. Therefore, **competition to acquire the best artists is decisive**….."*[138] (emphasis added).

In the same case, the Majors maintained that:

> *"the price uniformity can be explained by the existence of an oligopolistic market, characterized by price transparency, in which parallel behaviour is not the result of concerted practices by the operators, but the consequence of an intelligent adaptation of the operators' behaviour to that encountered in the market by the competitors. Moreover, there would be **a natural tendency***

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137 Upon request, we will submit a full copy of this decision to the Commission.

138 Decision of 9 October 1997, **Annex 14**, at point 106.

> ***to place the PPD for new phonografic carriers in the highest price range*** *given the impossibility of predicting the success of a title."* [139] (emphasis added)

94. These statements by the Majors give a realistic picture of the actual price-fixing process. In particular, they show that there is no room for a positive effect on consumer welfare (which Universal claims to be its major concern). Not a single cent of savings on costs is likely ever to be passed over to consumers (no "pass-over" effect).

95. Below is a table concerning four best selling albums by "The Beatles" distributed by EMI in Italy.

CD title	Catalog number	Release year	Current Price (Full price PPD practiced by EMI)
Abbey Road	CDP7464462	1969	€ 12,39
Help!	CDP7464392	1965	€ 12,39
Let it be	CDP7464472	1970	€ 12,39
Yellow Submarine	CDP7464452	1969	€ 12,39

96. All four albums were released over 30 years ago and, since their release, have been selling millions of units (in both vinyl and CD format). It is reasonable to assume: (1) that production costs (recording, artwork, and so on) of these albums have been fully amortized, (2) that there are no more marketing or promotional costs involved in distribution, and (3) that there are virtually no returns of sound carriers. Consequently, the costs of putting each marginal copy of these albums on sale to consumers are limited to duplication, and to artists' and copyright royalties.

97. Despite this, the albums mentioned are still sold at the same top-price as new releases of major artists, whose costs (not to mention the risks) are much higher. The prices of the old "Beatles" albums, far from taking account of consumer welfare, result from the desire of the Majors to maximize profits.

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139 Decision of 9 October 1997, **Annex 14**, at point 161.

98. The described *maintenance of top prices over many years* is possible because the Record Producer is able to fix the highest price that the consumer will accept thanks to the economic leverage deriving from its monopolistic position *as far as the artists are concerned*. In other words, if an Italian consumer wants to purchase sound carriers with the aforementioned songs by the Beatles, he has no option other than to pay the price.

99. The Majors' argument before the Italian Authority was that the price of phonograms was not dependent on *copyright royalties*. This argument is corroborated by the complainant itself.

100. Below is a table concerning data on four best selling albums by the renowned artist *Andrea Bocelli* in Italy, all of which are distributed by the complainant:

CD title	**Catalog number**	**Release period**	**Copyright incidence in function of number/ duration of protected works**	**Copyright royalty paid by UMI**	**Copyright on equivalent CD with 100% of protected works**	**PPD at time of release**	**UMI most practiced full price PPD in the same period**
Aria	SGRD77814	1/1998	23,24%	€ 0,238	€ 1,024	€ 11,88	€ 11,88
Arie Sacre	4644442	2/1999	50,24%	€ 0,561	€ 1,117	€ 12,39	€ 12,39
Verdi	4680462	2/2000	0,00%	€ 0,000	€ 1,163	€ 12,91	€ 12,91
Cieli di Toscana	3003682	2/2001	100,00%	€ 1,185	€ 1,185	€ 13,15	€ 13,15

101. Each of the four albums carries a different percentage of protected works, from 0% for the album "Verdi" (only with works from the public domain), to a maximum of 100%, for the album "Cieli di Toscana" (with all works copyrighted). Therefore, the copyright royalties vary from 0 to a maximum of € 1.185. One might expect – according to what the complainant claims – that the PPDs of the albums with a lower number of protected works (and therefore with a lower royalty payment) would be set at levels lower than the full price PPD resulting from the complainant's price list of the same period. However, this is not the case. The PPDs of the albums in question

are exactly the same as those of the other new releases. It is evident, therefore, that *different royalty payments have no influence whatsoever on the complainant's pricing policy*.

102. One further conclusion can be drawn: As noted by BIEM in its response, the net rate provided for by the Standard Contract was decreased from 9.306% to 9.009% in 1998. Notwithstanding this decrease, full price PPDs practiced by the complainant have been constantly, and steadily, increasing since 1998 (by 10.69%, from € 11,88 to € 13.15).

103. It is therefore extremely unlikely that the complainant will ever pass on to consumers any savings on copyright royalties. To our knowledge, such a "pass-over" effect has never occurred. The complainant should at least give examples of a "pass-over" effect since the complainant alone bears the full burden of proof with respect to an "abuse".

104. For the sake of completeness, we present the following "best-case" hypothetical:

- We set the copyright rate at 7.48% (net of all deductions), 17% below the current rate of 9.009%. This is the wildest ambit claim made by Universal – even taking into account their spurious "mark-up" claims and unsubstantiated discount claims;

- The complainant and the other Record Producers behave virtuously and pass the entire savings on copyright royalties on to the retailers;

105. In the example below we look at a top price CD by Andrea Bocelli called "Cieli di Toscana". The result of the 17% reduction in the creators royalty would be that the wholesale price of a full price album would be reduced at most by 20 eurocents:.

CD title	**Artist**	**PPD**	**Copyright at 9.009%**	**Copyright at 7.48%**	**Copyright difference**
Cieli di	Bocelli	€ 13,15	€ 1,18	€ 0.984	€ 0,20

Toscana					

106. No one could maintain that such a reduction (€ 0,20) would boost sales to an appreciable extent. It is extremely unlikely that the retailers would pass on the savings to the consumers. Retailers have their own pricing strategies. It is most likely that the retailers will leave the price unchanged. This is because a reduction of € 0,20 will not enable retailers to fit the CD in another price slot, such as e.g. from € 19.99 to € 18.99. No complicated formulae are needed to understand that if a popular new release record is selling at a price of € 19.99, retailers are unlikely to mark it down to € 19.79 in order to pass on that minor change to the consumer.

107. In order for rights holders to obtain the same total income as before, the sales increase resulting from a 17% reduction in the royalty would have to be of the scale of around 20.5%. At no point did the complainant explain how it wishes to achieve an increase of 20.5% of sales by way of a reduction of the consumer price from € 19.99 to € 19.79.

108. The Commission has apparently arrived at a similar conclusion concerning a change in VAT on musical recordings. The Commission has so far rejected the appeal of the record industry to lower the VAT on musical recordings. It seems that in the Commission's view such a change would have little influence on the consumer price and would not boost the sales to any appreciable extent:

> *"…Lowering the rate of VAT is often cited as a way of tackling the serious problems confronting the music industry, caused mainly by piracy and the growth of illicit and alternative markets, a worsening phenomenon throughout the world in recent years. [...]*
> *Nevertheless, it should be borne in mind that lowering the rate of VAT may not be sufficient to combat organised piracy effectively at the international level. In many cases a reduction in the rate of VAT is not fully passed on in the final price to the consumer. Even when it is passed on, the effect is normally only transitory and disappears in time. And even if the reduction were passed on completely, the price would still be higher than the black market price[…]"* [140]

[140] Answer of Commissioner Frits Bolkestein on behalf of the Commission on 28 February 2003 to a parliamentary question N° E-3841/02 by *Walter Vetroni*, OJ C 161 E of 10.07.2003, p.153.

c) No Link between the Standard Agreement and Consumer Choice

109. Neither the complainant's statements, nor logic or experience suggest any link between the terms of the Standard Agreement and consumer choice.[141] Consumer choice depends on the popularity of the relevant music. Sound carriers are a luxury product on which few people depend for their lives. Sales of sound carriers are outside the interplay of supply and demand. This is confirmed by the Majors' own statements in the abovementioned procedure before the Italian Authority:

> *"[…] the Majors asserted that for the individual consumer each title is unique and irreplaceable. In particular, according to Warner and BMG, the acquisition of a phonographic product is motivated chiefly by reasons of a psychological order and independent of the selling price. Therefore, for a producer, lowering its prices does not mean increased sales but merely a reduction in corporate profits. According to BMG, the producer strives to place the price of the products as high as possible so that it may still be bearable for the user base at which it is targeted. In the end, the final selling price of phonographic products is a secondary and not a decisive factor in the product's success".*[142]

110. The Majors themselves confirmed that a change of the sales price will not influence demand in a relevant manner.

d) The Need to Fully Safeguard the Interests of Authors, Composers and Publishers

111. The complainant and its economic expert fail to address paragraph 31 of the *Tournier* judgment which, for the creators, is crucial: Whatever the method of royalty determination may be, *the interests of authors, composers and publishers of music must be "fully safeguarded"*.

112. The complainant's theory clashes with this safeguard requirement. *Tournier* cannot be interpreted to mean that limitations on discounts, or provisions on minimum royalties and maximum track numbers must be removed as a matter of principle. If this occurred, *creators would be automatically linked to the commercial decisions of, and*

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141 See response, point 94.

142 Decision of 9 October 1997, **Annex 14**, at point 105.

to possible mismanagement by, the Record Producers; although these risks are beyond the influence of creators. Record Producers could dilute creators' income indefinitely – by their sole commercial decisions, and based on their sole random discretion.

113. The "*credo*" of the complainant is in favour of collective licensing and of the Standard Agreement.[143] However, this "*credo*" is hypocritical. In truth, the complainant wishes to reserve solely to itself the right to determine what the remuneration of creators should be: *Each price agreement between the complainant and its customers would be used as a parameter for the determination of the royalty due to the relevant creator*. Such behaviour is called "beggar thy neighbour".

7. No Specific "Unfairness" of the Four Points

114. The complainant suggests that the Standard Agreement fails to reproduce the outcome that would be obtained if market forces prevailed.[144] The complainant thus ignores BIEM's submissions. We have explained: (1) that the Standard Agreement has come about through arm's length negotiations; (2) that, as with collective labour arrangements, collective licensing for most creators is the only way to gain negotiating power and have market forces prevail in the first place[145]; (3) that the "*licence unique et globale*" and non-discriminatory licensing are the only way to ensure a fair and level playing field throughout the Common Market, and (4) that only collective licensing combined with the reciprocal contracts between the societies can bring about such a "*licence unique et globale*" and a level playing field in the common market, in which small Record Producers and newcomers can overcome the barriers to entry.

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143 See Universal's second submission, part A, page 14, points 2.1 and 2.2.

144 See Universal's second submission, part A, p. 5 and 6, point 1.1.

145 See response, points 22 to 27 and point 121.

a) The Necessity to Protect Intellectual Property and Culture

115. Community law guarantees special protection to intellectual property. See Articles 28 and 30 EC, first sentence ("protection of industrial and commercial property") and Article 17 (1) of the Charter of Fundamental Rights. Community law as a rule privileges intellectual property over the free movement of goods. It does not allow creators, as owners of intellectual property rights, to be forced to grant licences at any price.[146] Such exploitation would violate *the specific substance of intellectual property*. According to Article 151 (4) of the Treaty, if the Commission renders a decision on the present complaint, it would have to take cultural aspects into account. The complainant did not address any of this[147] in its second submission.

b) The Need to Protect Small Record Producers

116. Small Record Producers rely on lesser-known artists and composers. They produce and sell a smaller number of records. A small Record Producer cannot achieve the economies of scale of a large Record Producer, and therefore cannot match the Majors' volume discounts.

117. Contrary to the complainant's understanding[148], BIEM is not against the volume discounts which the Majors allegedly wish to offer. *BIEM only objects to financing these discounts to the detriment of the creators whom BIEM and its Member Societies represent*. This is in line with the holding of the Munich Court of Appeals ("*Oberlandesgericht München"*): Creators must not be put in a position where they have to share the risks of the Record Producers.

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146 See response, point 199.

147 See response, points 198 to 203.

148 See Universal's second submission, part C, page 34, point 55.

c) Level of Discounts

118. The complainant misrepresents the actual market realities. It repeats *ad nauseam* that "the discount structures within the Standard Contract […] are now out of date"[149] and that customers "demand hefty discounts from the record companies"[150]. However, nowhere in the complainant's submissions can we find concrete figures as to the complainant's discount policies. Nor is there any proof that the weighted average discount is in excess of the flat discount provided for in the Standard Agreement.

119. In fact, according to a recent audit of the complainant's accounts in a representative national market[151]:

- The Complainant grants retailers discounts which range between 0% and an absolute maximum of 19%, depending on the client and the products;
- Discounts are most frequently around 4 to 6% for small-to-medium sized retailers and 10 to 12% for prime clients;
- The weighted average of these discounts granted by the Complainant is 7.5 to 8%.

120. This weighted average of 7.5 to 8% is below the 9% flat reduction for discounts granted in the Standard Contract.

121. We conclude that Universal has failed to prove that the Standard Contract is out of line with current market realities, even though BIEM and its members are under no obligation to follow Universal's discount policies.

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149 See, e.g., Universal's second submission, part A, page 3, 2nd bullet point.

150 Complaint, page 36, at para. 5.14.

151 Performed by BIEM's member SIAE (Società Italiana degli Autori ed Editori) on Universal Music International accounts concerning sales in Italy.

IV. Requested documents from the Commission

122. BIEM would like to repeat its request for a non-confidential copy of the LECG study[152], or, if a non-confidential copy cannot be prepared, for a non-confidential table of contents and a summary of the study. We refer to point 166 of BIEM's response. A copy of the LECG study appears to be in Annex 16 of the complaint.

123. We would also like to request a non-confidential copy or a non-confidential summary of Annexes 1 and 2 to the complaint. The complainant relies on these Annexes for its surprising theory that lower consumer prices "can increase income to the publishing community".[153]

124. In addition, we would also wish to apply for non-confidential copies of all documents that third parties may have sent to the Commission in the context of the present case. Universal's second submission suggests that third parties have made submissions to the Commission.[154]

125. Finally, we would request for a non-confidential copy of the IFPI study of March 1999.[155]

126. Without access to the aforementioned documents, BIEM does not believe that it will be able fully to exercise its rights if the Commission continues to investigate the case.

D. Conclusions

127. BIEM and its members believe that Universal has been given ample opportunities to make its case. We do not believe that it is in the interests of due process for a further

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152 Relied on in points 1.11 and 1.12 of the complaint and in Universal's second submission, Part C, p. 15 seq., point 24. A copy of the LECG study appears to be in Annex 16 to the complaint. We have never obtained access to the LECG study – or any explanation as to why this study contains confidential information and a non-confidential version cannot be prepared.

153 See Universal's second submission, part A, p. 12, point 1.15 and p. 13, point 1.16.

154 See, e.g. Universal's second submission, part C, p. 42, point 73.

155 See complaint, § 4.10, response, point 167 and Universal's second submission, part C, p. 45, point 83.

round of comments to be received from the interested parties. While the Commission is free to take whichever course of action it deems necessary, BIEM would hope that Universal is not sent a copy of this second submission without a decision on the investigation being taken. As was the case after our initial submission in September 2002, this will simply spark a further round of comments and counter claims.

128. Universal has had "two bites at the cherry" in trying to substantiate its complaint. BIEM remains convinced that the motive for the complaint was for the Commission to intervene in the setting of the royalty rate due to the inability of IFPI to reach a negotiated settlement. Universal has failed to respond to the four points outlined in BIEM's submission of 6 September 2002. In addition, the economic study by Mr Ordover – which was the only new element presented by Universal – was based on a hypothetical scenario devoid of concrete economic data. This taken together with Universal's own unwillingness to produce the necessary data leaves BIEM members questioning the motives of the complainant. A *prima facie* case of an infringement of the competition rules has not been demonstrated and Universal is still to justify the Community interest for an investigation by the Commission. BIEM hopes that no further Commission time will be wasted and that the complainant be informed that the complaint has been rejected.