Comments of American Association of Independent Music (A2IM)

To U.S. Department of Justice and the Federal Trade Commission

On the matter of Draft Vertical Merger Guidelines

February 26, 2019

ABOUT A2IM

A2IM is a 501(c)(6) not-for-profit trade organization representing a diverse group of over 600 Independently owned American record labels. A2IM's independent community includes music labels of all sizes and staffing levels across the United States, from Hawaii to Florida, representing musical genres as diverse as our membership, including Bluegrass, Blues, Children's, Classical, Comedy, Country, Dance/electronic, Gospel, Folk, Hawaiian, Jazz, Hip-Hop, Latin, Metal, New Age, Pop, R&B, Reggae, Roots, Soca/Caribbean, Traditional American, World, and more.

"Independent" doesn't refer to a specific genre of music, nor does it mean lesser-known artists. For example, A2IM member labels have issued music releases by artists including Taylor Swift, Mumford & Sons, The Lumineers, Adele, Alabama Shakes, Arcade Fire, Run the Jewels, Bon Iver, and many others.

A2IM supports a key segment of America's creative class and small business community. As an organization, we are committed to protecting the value of America's Independent musical contributions and influence.

A2IM serves as a central voice for a diverse community of Independent labels operating within the United States. The A2IM organization represents Independents' interests in the marketplace, in the media, on Capitol Hill, and as part of the global music community. Our members combined yearly revenue amounts to $1.4 billion.

SUMMARY

A2IM agrees that the 1984 Non-horizontal Merger Guidelines are badly in need of an update. Independent labels and music listeners need to be able to have confidence that DOJ and FTC are committed to ensuring a healthy competitive market environment that serves diverse listening audiences with diverse music and have the tools and knowledge to meaningfully assess the competitive landscape. Unfortunately, these draft guidelines fall short of that goal, and would continue the status quo of excessive tolerance. At a time when the independent label community faces the prospect of an

onslaught of new vertical and horizontal integration[1] with high potential for exclusionary conduct and anti-competitive harm[2], this would be an unacceptable outcome.
We share many of the concerns raised by Commissioners Chopra and Slaughter in their respective dissents—and the concerns of many antitrust experts and economists. In this brief comment, we will seek to illuminate some of these concerns in ways that are specific to our industry.

Vertical Guidelines must reflect current economic reality

A2IM's members operate in the context of a recorded music marketplace that is indisputably more concentrated than in 1984 when the U.S. Dept of Justice published its Non-horizontal Merger Guidelines[3]. In 1984, there were six major labels; today, just three companies—Universal Music Group, Warner Music, and Sony Music control between 62 and 70% of the market, depending on the method of measurement. Consolidation in the sound recording marketplaces can be measured alternatively on the basis of ownership or on the basis of distribution (that is, where an independent entity owns the master sound recording but relies on a major record label for distribution). Independent market share is estimated at 38% on an ownership basis and a lower amount of 30% on a distribution basis.[4]

As a result, independent labels, though phenomenally diverse—in their scale, in their products, and in the audiences they serve— find the marketplace to be profoundly shaped by the choices, preferences, and actions of the largest companies. Owing perhaps to an over-reliance on theoretical models, the draft guidelines don't engage deeply enough with the actual business realities our members face:

Consolidation is happening everywhere.
Independent record companies are often dependent on businesses in adjacent marketplaces to effectively bring our product to the marketplace and are best served when those adjacent marketplaces are themselves fair and competitive. Our businesses can be impacted by developments, including ownership consolidation, in industries such as broadcasting (both terrestrial FM and satellite), digital streaming (both non-interactive and interactive), music publishing, live music promotions and ticketing, internet service providers, print and digital media, physical and digital retail, shipping, media manufacturing (including vinyl lacquers and pressing plants), advertising technology, and consumer

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[1] See, e.g. Glenn Peoples. "Music Companies' Key To the Future: Build Up and Expand Out or Die Trying." *Billboard.* (October 25, 2019) https://www.billboard.com/articles/business/8540684/music-companies-horizontal-vertical-growth-analysis

[2] See, e.g. Cherie Hu. "Music Biz Slams Citi Report on Industry & Artist Revenue as Inaccurate, Inconsistent." *Billboard.* (August 10, 2018) https://www.billboard.com/articles/business/8469666/citi-report-music-biz-industry-artist-revenue-inconsistent-analysis

[3] U.S. Dept of Justice. Non-Horizontal Merger Guidelines (June 14, 1984) https://www.justice.gov/sites/default/files/atr/legacy/2006/05/18/2614.pdf

[4] Worldwide Independent Network. "Wintel Worldwide Independent Market Report 2018" http://winformusic.org/files/WINTEL%202018/WINTEL%202018.pdf

technology. Consistent with trends across the broader economy, we have witnessed consolidation in many of these sectors, in some cases resulting in massive shifts of power towards the largest firms.

Data has become a currency.
Commissioner Chopra rightly notes that today, "many mergers are motivated by a thirst for data. But deals animated by the acquisition and combination of different data streams are often difficult to characterize within the traditional boundaries of 'horizontal' and 'vertical' integration."[5] Understanding the overlapping dynamics between markets for cultural goods, markets for consumer data will require a broader assessment of market power than is possible with blunt tools like the draft guidelines' 20% safe harbor threshold.

Financialization and private equity change the landscape.
The draft guidelines rest on theoretical assumptions that companies will behave in ways that simply increase profits, but the rise of financialization, and the shift towards an emphasis on returns for Wall Street or private equity has upended many of the old assumptions about what animates decision-making. Scholars have documented how private equity[6] can sometimes adopt an asset-stripping approach that focuses on acquisition, quick inflation of perceived value and exiting with the short-term spoils, rather than building sustainable long-term businesses. Independent music has already been indirectly impacted by how this dynamic has tragically played out in terrestrial radio and print journalism. As financialization in recorded music becomes more of a factor, agencies must be attentive too. More retrospective analysis of completed mergers and choices about whether to intervene is clearly warranted. We agree with Commissioner Chopra that this should include careful consideration of buyer-specific factors. New guidelines need to be able to consider these buyer-specific factors as well.

Draft guidelines would benefit from understanding the problems of partial vertical integration and vertical shareholding

A central concern that arises from vertical mergers and vertical shareholding in the recorded music business is foreclosure, both input foreclosure and customer foreclosure. Independents, in particular, are at risk of being shut out of existing and emerging markets. A digital service may choose to treat different recorded music suppliers differently on the basis of financial relationships. For example, a service could give certain preferred music catalog in which it holds shares, better placement in app interfaces, could feature this music in playlists or offer preferred algorithmic ranking, in ways that are essentially invisible to consumers, while excluding competitors from such placement. Such a service might even exclude such music from the service entirely or offer rival firms less advantageous terms for the use of their catalog.

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[5] Rohit Chopra. Statement Regarding Request for Comment on Vertical Merger Guidelines. (January 10, 2020) https://www.ftc.gov/system/files/documents/public_statements/1561727/p810034chopravmgabstain.pdf

[6] Matthew Crain. "The Rise of Private Equity Media Ownership: A Public Interest Perspective" *International Journal of Communication*, USC Annenberg. (2009) https://ijoc.org/index.php/ijoc/article/view/381

The draft guidelines do not offer sufficient guidance for regulators seeking to engage foreclosure questions which rise from common investor ownership of vertically related corporations, where there is some degree of shared ownership across the vertical axis in the supply chain, but where shared ownership falls short of a full merger. A recent *Harvard Law Review* note argued that vertical shareholding may actually be more likely than vertical merger to have anticompetitive effects, especially with regard to foreclosure.[7] While some vertical shareholding arrangements are benign, the problems become especially acute in contexts where a dominant platform and/or a dominant supplier is involved. When both a dominant platform and a dominant music company are involved, the potential for harm grows even further.

One timely example is the sale of 10% of Universal Music Group, the world's largest music company, to the Chinese firm Tencent, announced on Dec 31, 2019.[8] Reports also indicate an option for an additional ten percent stake is under consideration. Tencent dominates many markets in Asia; it currently owns four of the five leading music apps in China with 90% market penetration[9] and has expressed its intentions to expand further across Southeast Asia. Tencent also owns the streaming service Joox which is the market leader in Indonesia, Malaysia, and Thailand. The company also holds a $115m stake in the Indian streaming service Gaana, and since 2017 has held an equity stake in Spotify. Pending approval, this deal has potentially massive ramifications for the recorded music business on its own but is widely reported to presage further deals to come. There is potential for discriminatory treatment of independent music catalog as well as discriminatory treatment of rival streaming services.

The current draft guidelines offer little reassurance that agencies will approach such transactions with sufficient scrutiny or have guidance to understand and address the full range of competitive concerns. As reports indicate additional UMG transactions may be coming in the near future, raising a range of concerns about competition, data, and privacy, it's vital that regulators pay close attention and swiftly intervene to prevent harm.

Vertical guidelines must explicitly name factors other than price

When independent labels face customer foreclosure as a result of vertical integration, this has a clear impact on their ability to continue to invest in production. As a result, some firms may slow production, reduce investment, or exit the marketplace entirely. Economists would rightly describe these impacts in terms of innovation harms and quality harms, but such harms to consumers are scarcely mentioned in the draft guidelines. From a public interest perspective, it's important to be clear that these harms are

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[7] "Vertical Shareholding," *Harvard Law Review* (Dec. 10, 2019.) https://harvardlawreview.org/wp-content/uploads/2019/12/665-681_Online.pdf

[8] Cherie Hu. "Chinese Tech Giant Tencent Wants A Piece of the World's Largest Record Label." National Public Radio.. (January 8, 2020.*) https*://www.npr.org/2020/01/08/794515696/chinese-tech-giant-tencent-wants-a-piece-of-the-worlds-most-successful-record-la

[9] Rebecca Davis. "China's Tencent Music Entertainment Spooks Investors with Q2 Report." (August 13, 2019.) https://variety.com/2019/music/news/tencent-music-entertainment-vivendi-universal-media-group-1203300603/

not abstract. The viability of vibrant independent labels with diverse modes and scales of operation is crucial for cultural diversity and community expression, for the sustainable propagation and preservation of many of America's precious cultural traditions, and for the innovative forms of music to come.

Guidelines should enumerate contexts where an anticompetitive presumption applies.

Jonathan Baker, Nancy Rose, Steven Salop, and Fiona Scott Morton have argued[10] that agencies should operate with a rebuttable presumption of anticompetitive harm when certain conditions are met. Of special interest for the independent label community is Baker et al's suggestion of a *dominant platform presumption.* Adopting this presumption would protect against scenarios where a dominant platform "acquires a firm with a substantial probability of entering in competition with it absent the merger, or if that dominant platform company acquires a competitor in an adjacent market." Such a presumption could prevent situations where a dominant company in one part of the market is able to extend its market power over other segments and force independent labels to accept its terms as a condition of market access.

Guidelines should indicate a clear preference for blocking mergers where competitive harm is likely, rather than resolving though remedies or expecting *ex post* antitrust enforcement.

The guidelines should caution that vertical mergers are unlikely to be resolved through remedies or *ex post* antitrust enforcement.[11] A finding of competitive harm should thus result in the challenge of a merger, rather than other proposed resolutions. Conduct remedies, in particular, are often ineffective and require significant agency resources to enforce. Conduct remedies also require ongoing efforts by impacted businesses, but small and medium sized businesses like independent record labels typically lack resources to monitor for violations of behavioral conditions; they are simply focused on keeping their own businesses afloat. As Economides et al note, "Once a dominant firm has been permitted to extend its power throughout the supply chain, it is difficult to police discriminatory behavior via the antitrust laws." The pervasive use of non-disclosure agreements across the digital music industry presents another barrier to policing such behavior: in some cases it can be very difficult for an independent label to gather evidence of exclusionary conduct by one of its actual or potential upstream or downstream partners, even as the anticompetitive harms may be very real.[12]

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[10] Jonathan B. Baker, Nancy L. Rose, Steven C. Salop, Fiona Scott Morton. "Five Principles for Vertical Mergers" *Antitrust,* Vol 33. No. 3 (Summer 2019). https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=3166&context=facpub

[11] Nicholas Economides, John Kwoka, Thomas Phillippon, Hal Singer, Lawrence J. White, Comments on the DOJ/FTC Draft Vertical Merger Guidelines (February 2020). http://www.netinst.org/Economides_20-04.pdf

[12] Perversely, in some cases, small businesses who seek to compare deal terms to ascertain whether they are victims of discriminatory conduct or to alert their peers to such concerns may be accused of illegal coordination.

Conclusion

For all the aforementioned reasons, we urge that these guidelines not be adopted in their current form. Instead, we urge both the FTC and DOJ to redouble their efforts to proactively engage with the concerns of small and medium sized businesses like those represented by A2IM. In the interim time until the necessary improvements and revisions are made, agencies must monitor any current and future vertical transactions involving the biggest players in recorded music especially closely.

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