



IMPALA: RESPONSE TO THE EC'S PRELIMINARY REPORT ON THE E-COMMERCE SECTOR INQUIRY DATED 15 SEPTEMBER 2016

Identification number in the register: **12383069253-19**

IMPALA – Independent Music Companies Association AISBL is an international, not for profit association, with a limited budget, which is incorporated under Belgian law. It is a legal person and was incorporated in 2000. It has over 4,000 members, all of which are independent music companies. One of its purposes under its statutes is to promote the general interests of its members, inter alia at the level of the European Institutions. As such, IMPALA is not a “provider of online products”, but rather represents companies, independent music companies, which are producing recorded music and in that sense are “providers of online content” and who are included within the scope of the e-commerce inquiry.

As an association representing a large proportion of the independent music community in Europe, IMPALA has been keen to input into the EC's e-commerce inquiry, and to provide a general overview of issues affecting the digital recorded music market and its cross-border development in the EU on behalf of its members. IMPALA already provided a response to the EC's questionnaire to right holders on 15 April 2016.

Our members are at the forefront of the digital market. They have worked hard to make their repertoire easily accessible for licensing in a one-stop-shop via Merlin, in view of the fact that the independent sector is highly fragmented. They always aim where possible to license on the widest basis possible, at least Europe-wide and preferably globally. At the same time, they aim to support local services, local repertoire and local language repertoire, not just Anglo-American repertoire, as this is fundamental to ensuring cultural diversity and that local repertoire is able to flourish and reach as wide an audience as possible.

EXECUTIVE SUMMARY

As we have explained in IMPALA's questionnaire response of 15 April 2016, we think it is important that, when the EC considers its final findings in relation to the e-commerce sector inquiry as regards licensing practices in the digital market, it takes into account the specificities of the different sectors in which these licensing practices take place. For this reason, we repeat here the background provided in that submission concerning the music sector.

We have then made a series of comments on the Preliminary Report as it relates to the music sector.

In addition, as we have said previously, we believe this sector enquiry should look beyond geo-blocking and territoriality, and licensing practices, to other issues affecting the development of a competitive digital single market in the music sector. There are three main areas of competition issues that we highlight as they relate to the context in which digital licensing agreements actually occur:

- Abuse of market power by online platforms vis-à-vis suppliers, particularly SMEs
- Distortions of competition between digital services
- Power of major music companies to mould services and create restrictions

One particular challenge is the “power gap” between online platforms, where such platforms are indispensable trading partners due to the sheer number of users visiting their platforms, and their licensing partners, and their behaviour to those trading partners, especially independent music companies.

One question is whether regulatory action is required to ensure that platforms do not abuse their strong market positions. IMPALA is of course aware of the EC's Communication on Online Platforms and the Digital Single Market and the EC's conclusions concerning the role of competition law in this context. IMPALA is also aware that the EC is currently carrying out a fact-finding exercise concerning B2B practices as regards online platforms to determine whether additional EU action is required beyond competition law to address the fairness of B2B relations, including as regards SMEs, by spring 2017.

There are also issues as regards the access, and the terms and conditions of access, of independent music companies to the digital market: in particular, whether action is required to prohibit unfair trading practices and discrimination, and to ensure a level-playing field for these SMEs to compete and reach a wide, cross-border audience with their music content.

In addition, IMPALA would suggest that the EC takes the opportunity, as part of the e-commerce enquiry, to review whether the current competition rules and the way in which concepts such as dominance, abuse, relevant market etc. are defined are fit for purpose in the digital world or whether competition policy needs to be updated to respond to its challenges.

This is on top of addressing the copyright value gap issue, which is not a competition issue as such but which also fosters market abuse.

A. BACKGROUND

1. Structure of the market on the supply side

The EC has identified a separate digital recorded music market, which, like the physical recorded music market, is dominated by the three major record companies, Universal Music Group (UMG), Sony Music Entertainment (Sony) and Warner Music Group (WMG). These companies together hold an estimated market share of around 70-80% of the EU/EEA recorded music market, which is thus highly concentrated.

In addition, the recorded music market has experienced a number of years of decline, as physical recorded music sales, i.e. CD sales, decreased. This trend now seems to have started to reverse, as 2013 saw growth in the EEA for the first time since 2002: this growth was driven by the digital recorded music market. The growth of digital continued in 2014 and 2015, as global digital revenues grew respectively by 6.9% in 2014 and 10.2% in 2015, and in 2015 the portion of revenues derived globally from the digital recorded music market overtook revenues from physical formats for the first time. Overall global music revenues returned to growth - after a couple years of limited decline due to a further global decline in physical, as well as a decline in downloads - with an overall increase of 3.2% in 2015. (see IFPI Digital Music Reports 2015 & 2016).

In short, the future of the music industry is as a global digital industry. Given this, during the proceedings in *Case No. COMP/M.6458 – Universal Music Group/EMI Music (“UMG/EMI”)* IMPALA argued how important it was for the future of the industry to ensure that no artificial barriers to entry were erected on the digital side of the market. In particular, IMPALA argued, this could detract from the opportunity represented by digital services to create a more level playing field in the recorded music market for all competitors, especially smaller competitors such as the independents. The EC also acknowledged the importance of access to the digital market for the independents in, for example, MEMO/12/696 accompanying the announcement of the *UMG/EMI* decision, where it stated that, as a result of the final decision subject to conditions in the case, “[in] particular, [as a result of the remedies] Universal will likely not be able to reduce [the independents’] access to digital platforms, which are particularly important for Indies to sell their music.” In particular, the growth of digital provides an opportunity for the independents to sell their music more easily across the EU rather than merely in their home markets.

The highly concentrated market on the supply side of the market, the digital recorded music market, with three major record companies dominating the market, is a potential obstacle to a level playing field for all competitors.

2. Structure of the market on the distribution side

On the distribution side of the market, there are a number of large online platforms, whose business models make them de facto indispensable trading partners (e.g. YouTube, Apple, Spotify, etc.).

This can lead to a “power-gap” developing between certain platforms and their content licensors, especially if these latter are SMEs such as independent music companies.

This type of situation can impact on the quality and types of deals available to smaller independent music companies, and even whether deals and thus access to services are available at all, and thus whether their repertoire, often local or national repertoire, is available on a cross-border basis across the EU.

Certain platforms may also benefit from network effects, as the number of users has a knock-on effect making the platform more attractive to advertisers and content providers and, in turn, with more attractive content, attracts even greater numbers of users.

This happens when the number of unique users accessing a platform greatly exceeds that of its competitors, regardless of actual turnover generated. In this case, the “power gap” mentioned above is even greater.

3. Cultural diversity – promoting access to music across borders

Linked to potential restrictions on the cross-border sale of music content is the issue of cultural diversity, enshrined in Article 167(4) of the EC Treaty, and the fact that much local or national repertoire resides with the smaller independent music companies, while the majors tend to focus more efforts on Anglo-American repertoire, which migrates more easily.

In a content market like the music market, one of the results of ensuring cultural diversity is that it also ensures consumer choice and thus constitutes a benefit to consumers. Ideally, the digital recorded music market should, as already mentioned above, provide a level playing field for all competitors, as well as one in which local/national repertoire would be able to migrate more easily. It is vital to prevent the erection of artificial barriers to entry to the digital market and to cross-border sale of independent music.

It is also important to note that smaller companies such as the independents often work with a network of partners in different countries to ensure their artists have the best chance of breaking borders. This is alongside arrangements to grant multi-territorial licences as regards digital through for example, Merlin (see more below).

4. Copyright – territoriality and value gap

Independent music companies and their artists, recognising both the opportunities provided by the digital market for smaller right holders, as well as the difficulties that may arise for digital service providers in obtaining rights to their music given the fragmented nature of the independent sector, have their own worldwide licensing agency – a one-stop-shop called “Merlin” designed to grant copyright licences to facilitate multi-territorial licensing.

Despite this, friction in the licensing market remains due to an unintended “value gap” referred to in point 3 b) below. In general, IMPALA expects that the EC, when coming to final conclusions on the e-commerce sector inquiry in the final report due to be published in early 2017, will of course bear in mind other ongoing Digital Single Market initiatives, such as the proposed Directive on copyright in the digital single market. This already contains proposals to deal with the value gap, for example.

Copyright is intended to ensure that right holders can grant licences freely and negotiate terms that result in proper remuneration for their work. Those who

distribute or intervene in distribution of creative works are active and responsible for obtaining copyright licences under the Copyright Directive.

Despite this, some distributors claim they are neutral carriers who can benefit from the so-called 'safe harbour', a practice that is distorting the market. Some music distributors attempt to hide behind the host exemption to minimise their responsibilities for content posted on the platform, thereby inflating their negotiating position vis-à-vis right holders. As a result, some of the largest music services are “under-licensing” or not licensing at all. This situation is detrimental to the music eco-system as a whole, due to the gap in revenues. It also distorts competition at the level of the music services particularly those who are more fully licensed such as Spotify and Deezer.

IMPALA also notes that the development of local services offering local repertoire is crucial. On the supply side, it may seem obvious, but copyright owners can only license what they own and/or are able to license. Likewise, on the distribution side, some services are simply not able to license or offer a service Europe-wide for financial and/or logistical reasons.

A balance should be maintained between focussing on geo-blocking and territorial restrictions, and ensuring that the conditions in which small local services can flourish are in place. In some cases, small local services simply cannot afford to license rights beyond one or two countries. This does not imply competition issues. Moreover, local services may wish to adapt local terms and offerings according to local market conditions. Our members also rely on a network of local experts (licensees) to help break artists across borders, and care should be taken to ensure that the way in which the opening up of cross-border supply of content is implemented does not result in a narrowing of opportunity for more diverse repertoire. This could result in a hindrance to cross-border activity - the opposite effect to the one the EU desires. This would be a serious blow for cultural diversity.

5. Competition rules and regulatory framework

In addition, IMPALA would suggest that the EC takes the opportunity of the e-commerce inquiry to review whether the current competition principles such as dominance, essential facilities, relevant market are fit for purpose or whether competition policy needs to be updated to respond to new challenges in the digital world.

There are also possible regulatory aspects to consider, as regards the access, and the terms and conditions of access, of independent music companies to the digital market. In particular, it will be important to consider whether action is required to facilitate access and prohibit unfair trading practices and discrimination against these SMEs, and therefore to ensure a level-playing field for them on which they are able to provide effective competition and reach a wide, cross-border audience with their music content.

B. COMMENTS ON THE PRELIMINARY REPORT: MAIN LICENSING PRACTICES IDENTIFIED BY THE EC

1. Contractual restrictions regarding transmission technologies

We agree with the EC's findings in the music sector. In general, as regards music agreements, the EC found that most types of transmission technologies were not explicitly mentioned – with the exception of online and mobile because those are the most prevalent.

2. Contractual restrictions regarding territories

We note that the EC found that in 57% of agreements reviewed in the music sector, digital content providers were required by contract to implement geo-blocking. This does not appear to be the case in the independent music sector.

As mentioned above, IMPALA is not itself an online content provider and as a trade association is not party to actual licences granted by its members. However, as a general comment, we understand that the strategy of members is to license as much as possible to generate revenues for their artists and to help them reach across borders. We understand that territory generally reflects two factors: the demand/coverage of the company seeking the license and the rights situation of the company granting the rights. In other words, licences will be granted for the whole of Europe and also the world to the extent rights are available for those territories. Any territories which may be missing would generally be down to lack of coverage or demand from a service or because it is covered by another licensing agreement.

3. Exclusivity provisions

We refer to the EC's finding that nearly half of all the agreements looked at on digital markets contained some form of exclusivity but that the smallest proportion of exclusivity was to be found in digital content providers' agreements relating to music (just over 20%). As we noted above, we understand that the strategy of members is to license as much as possible to generate revenues for their artists and to help them reach across borders. As a result, agreements in the independent sector are generally not exclusive.

4. Duration of agreements

We note that the EC found that right holders tend to have fairly long-term agreements with digital service providers but that music was again the content category where this was the least true. Our understanding is that our members generally have not entered into long-term agreements with digital providers.

Conclusion

Moreover, we agree with the EC's finding set out in note 348 of the Preliminary Report as regards the concern that new entrants may not be able to obtain licences to provide digital content online due to contractual restrictions in relation to transmission technologies, release windows and territories: "This concern seems to apply less to music products than all other products on which the sector inquiry sought evidence. *This is due to the fact that music products tend to be licensed with fewer restrictions and make less use of exclusive licensing.*"

C. COMPETITION ISSUES IN THE ONLINE MUSIC MARKET

IMPALA would also wish again to bring the following issues to the EC's attention in relation to the cross-border provision of music content in the EU in the context of the e-commerce sector inquiry.

1. Issues arising from the exercise of market power by platforms, particularly as regards SME suppliers:

- a) The position of platforms should be assessed in terms of competition and development of online services, as well as in terms of treatment of SME suppliers to platforms. Our experience is that there are competition issues and they arise out of the power of platforms. This can be seen in terms negotiated and also in the approach of platforms to suppliers. This is also exacerbated by the structure of the music market itself, which is centred on 3 major companies (see more under 3 below).
- b) Patterns of commercial behaviour such as aggressive commercial behaviour/negotiating tactics by dominant services in the digital market are prevalent. This is particularly so vis-à-vis smaller repertoire owners, these can range from “threats” to remove content or block access, with a view to extracting unfair or disadvantageous licensing conditions from them, to the insistence on overly stringent non-disclosure agreements, or the use of obtuse contractual language resulting in agreements lacking clarity. One example was the negotiations between the independent music companies and YouTube in relation to the launch of its new service, Music Key. Another was the launch of Apple's new music service, Apple Music.
- c) This competition issue is exacerbated where platforms are de facto indispensable trading partners, and indeed some may benefit from “network effects” as mentioned above, where the number of users has a knock-on effect making the platform more attractive to advertisers and content providers and, in turn, with more attractive content, attracts even greater numbers of users. This happens when the number of unique users accessing a platform greatly exceeds that of its competitors, regardless of actual turnover generated. In this case, the “power gap” mentioned above is even greater.
- d) The competition issues that arise for independents include barriers to access, or discriminatory access conditions:
 - Discriminatory provisions are applied by online music services, as between large and small repertoire owners, either with respect to access to the service itself, or to the terms and conditions of such access.
 - How negotiated terms are assessed and compared is important, including for example, base royalty per stream or download percentage rates, lump sum advances or annual guarantees, listener hour royalty streaming guarantees/income not attributable to specific artists' tracks or specific distributed labels, volume incentive bonuses, equity stakes in digital services and advertising/promotional carve-outs. Further, the impact, for example, of high advances and so-called “breakage” as regards effective royalty rates is also important. In other words, if the

amount of the advance or guarantee exceeds the actual amount earned (i.e. number of streams multiplied by the based royalty rate), the label will earn what is termed as “breakage” in excess of the actual earned amount, which impacts the effective royalty rate.

- In addition, digital services generally approach the majors first when negotiating deals with the record companies, which can result in less favourable terms or even less favourable access for the smaller, independent music companies.
- Examples of the above phenomena are the negotiations of YouTube in relation to the launch of its new Music Key service, and negotiations with other services, such as Apple’s iTunes in the past, and Apple Music more recently. As regards YouTube, the situation even led to a competition complaint given the severity of the situation, with the platform tying two different services together, offering discriminatory terms and threatening to cut access to the free service’s monetisation system and by also threatening to remove content from the free service if labels did not agree to terms offered for YouTube’s new service.
- The situation also has consequences for services since, depending on how advantageous the terms achieved by the majors may be, they may also have an impact on whether it is financially viable for new and developing digital services to expand their offering across the EU.
- The potential existence of Most Favoured Nation clauses may also need to be investigated. We understand that Least Favoured Nation Clauses may also exist, where post signing a service can impose terms that are less favourable if such terms are agreed with another supplier.
- The practice of basing advances granted in agreements with digital services on market shares linked with distribution (i.e. market share is calculated including both the repertoire owned, as well as that distributed, by the majors) is problematic. This may be exacerbated by the fact that major distributors often insist on the inclusion of online rights in distribution/licensing agreements for physical product so that independent companies are not free to distribute their music content online separately from their physical distribution arrangements (although they might prefer to).
- There are also technical barriers to the delivery of music content to digital services, e.g. barriers to access to content uploading programmes, or to rights management programmes such as Content ID on YouTube, which may hinder the ability of smaller players to deliver owned content, or, in the case of Content ID, to identify, and then to block or to monetise user-generated content containing owned content.
- Discrimination between large and small repertoire owners can also exist at the level of search and data, which may in turn affect terms and conditions of access to online music services. One solution would be to establish a non-discrimination principle applying to both search and data and online music services.

- Generally, there are discriminatory access conditions to the means of creation, promotion, production and distribution, for example, to YouTube, a key discovery and information tool, or iTunes (see 1 b) above).
 - Access to playlists is also a key issue as they dominate music fans' consumption of music online. It is vital to ensure that there are no barriers in this key part of the market.
 - The question of playlists and their power and the issue of access is the subject of these reports: *Part 1 – Winners & Losers in the Battle for Spotify Playlist Supremacy* (available [here](#)) and *Part 2 – Justin Bieber & The Self-Perpetuating Upward Spiral* (available [here](#)). The main findings are also summarised [here](#).
 - At the time of the first report (published a year ago), Spotify had 97% of overall playlist impact by feature and follower count. The other significant curated brands include the majors' own playlist services, which of course have considerable followers but still lag way behind Spotify - Digster/HITS has 1.5%, Filtr has 0.8% and Topsyfy has 0.2%.
 - The report also gives a good overview of the extent to which the major repertoire dominates Spotify playlists: on the basis of the data used for the report, Universal has 12 acts in the Top 20, followed by Sony on 4 and Warner on 3. XL (Adele) is the only independent artist in the Top 20.
 - Of course, the way in which access to playlists is secured has been the subject of investigation within the sector and certain publications have run [features](#) on allegedly abusive practice like [payola](#) (pay for play), with key services such as Spotify taking steps in this regard as summarised [here](#).
 - The question of access is also important because powerful playlists have a serious impact on other areas of the business.
 - For example, streams play a crucial role in chart positions as they are counted in charts. Chart eligibility rules are the subject of considerable debate and rules are determined territory by territory, with the agreement of the music industry.
 - The net effect is that the current situation makes it more difficult than before to get high chart positions without playlist support.
 - This in turn impacts radio exposure, as radio is increasingly driven by charts and playlists. Poor radio support reduces streaming as many consumers tend to stream what they hear on radio. This spiral effect squeezes the space for independents - in playlisting, in chart positions, in radio access etc. Introducing video streaming to charts (i.e. counting video streams in charts) will exacerbate this.
 - This underlines how the online market, whilst opening up new opportunities, is also subject to the same concentration factors as the offline world, particularly where it becomes mainstream.
 - Ensuring competition is vital and the above is a good example of today's access to media issues flagged previously by the Commission in its assessments of competition in the recorded music.
- e) All of the above could potentially restrict the ability of smaller record companies to compete on a level playing field and reach a wider, cross-

border audience with their music. This is serious because of the independent sector's vital role in developing artists and taking risks and ensuring innovation and choice for music fans, accounting for over 80% of all new releases.

2. Issues relating to distortions of competition between the digital services

- a) This may consist of unfair competition between digital services whereby some digital services systematically and potentially abusively claim they benefit from the “safe harbour” exemption and also abuse the notice and take down system. This raises both competition concerns, as well as copyright and regulatory issues.
- b) One of these issues is the so-called unintended “value gap” which needs to be closed by clarifying that those who distribute or intervene in distribution of creative works are active and responsible for obtaining copyright licences under the Copyright Directive, and are not neutral carriers who can benefit from the so-called 'safe harbour', as some of them continue to claim. Some music distributors attempt to hide behind the host exemption to minimise their responsibilities for content posted on the platform, thereby inflating their negotiating position vis-à-vis right holders. As a result, some of the largest music services are “under-licensing” or not licensing at all. This situation is detrimental to the music eco-system as a whole, from authors and performers, all the way to properly licensed music services such as Spotify and Deezer.
- c) Press reports concerning actions by digital services against other digital services, which suggest that dominant players may be attempting to use their market power to undermine competitors running other services, particularly freemium.

3. Issues arising from the market power of the major music companies to mould new services and create new restrictions:

- a) When services come onto the market with agreements already in place with the majors, who are the market leaders, this gives the majors power to mould the development of the service, for example as regards price but also as to how services are delivered. (This could include placing limitations on how freemium services are delivered, e.g. instead of unlimited free access, free access on a number of limited occasions during a specific period, etc.).
- b) There are also concerns about whether the power of the majors means that they are able to extract value in a way that may have an impact on whether it is financially viable for new and developing digital services to expand their offering across the EU.
- c) The potential existence of Most Favoured Nation clauses in the agreements between major record companies and digital services has already been flagged by the EU as a problem (for example in the UMG/EMI merger decision) and this may also need to be investigated on a wider basis, as mentioned above in 1).

- d) In IMPALA's view, the power of major suppliers can also have the effect of recreating the physical shopping experience or shop window or radio experience online, with greater prominence given to listings of the majors, and the majors dominating key facilities like advertising or playlisting (see more above) in the way they have offline, etc., which also impacts chart positions and access to radio and other media. This effectively directs consumers in the same way as in the offline world.
- e) The above creates barriers to competition, and also stifles innovation, applying the traditional offline format to a new medium rather than allowing digital services the requisite freedom to develop new and innovative services for consumers. Moreover, such barriers may also have an impact on whether, or how quickly, new and developing digital services expand their offering across the EU.

CONCLUSION

In summary, as set out above, we welcome the EC's preliminary report and agree with many of the EC's findings as regards the music sector. Where this is not the case, we have indicated this above.

However, we consider that the e-commerce sector inquiry should also look beyond the focus on vertical restraints in considering the competition issues that may hinder the development of a truly EU-wide digital recorded music market and thus cross-border sales of music content. As explained above, we consider that there are three main areas of further competition issues that we would suggest that the EC investigate as part of the e-commerce sector inquiry since they are key to the context in which the vertical agreements investigated by the EC occur:

- Abuse of market power by online platforms vis-à-vis suppliers, particularly SMEs
- Distortions of competition between digital services
- Power of major music companies to mould services and create restrictions