MUSICNET & PRESSPLAY: TO TRUST OR ANTITRUST?

Efforts by leading record labels to fill the void they created by shutting down Napster led several to develop their own subscription online music service. The author of the following iBrief assesses the viability of those services in light of a Justice Department antitrust investigation into the practices of the labels in allegedly quashing smaller distributors and colluding to stifle competition, and considers the ramifications of an antitrust suit for both the major labels and their competitors.

Introduction

Since the once popular music-swapping service, Napster, shut down as a result of the lawsuit brought against it by the major recording companies, the labels have been struggling to fill the massive void left in its wake. The growing demand for online music services has lead the Big Five – AOL Time Warner, Bertelsmann, EMI, Vivendi Universal, and Sony – to create their own channels for distribution.[1] The result: MusicNet and PressPlay, two for-pay subscription services formed as a result of joint ventures between the major labels.[2] However, the labels have already been criticized by trade groups, legislators, even Napster's Judge Marilyn Patel, for using MusicNet and Pressplay to squeeze out smaller players in the online distribution market by denying the competitors' rights to their music licenses and unfairly controlling distribution fees.[3] This has caused the Justice Department to launch an investigation of the music industry's licensing practices for possible antitrust violations. Some argue that collusion is a necessary reality in this fledgling online market.[4] Others think that such a monopoly would allow the major labels to dictate the entire direction of the online music industry, controlling the price and terms of use of digital distribution.[5] One thing is certain - should the Justice Department decide to bring a civil suit against MusicNet and PressPlay, the shape of the online music market could be changed forever.

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[1] *See* Clint Boulton, "Justice Department All Ears For Online Music Antitrust Vibe" http://www.internetnews.com/bus-news/article/0,,8161_860531,00.htm.

[2] *See* John Healey, "Antitrust Probe of Music Firms Intensifies" http://www.latimes.com/business/la-000082195oct15.story.

[3] *See* Laura Rhode, "DOJ Presses PressPlay, MusicNet" http://www.pcworld.com/news/article/0,aid,5,7125,00.asp.

[4] *See* Brad King, "Music Rights Battle Spins On" http://www.wired.com/news/print/0,1294,47632,00.html.

[5] *See* John Healey, "Antitrust Probe of Music Firms Intensifies" http://www.latimes.com/business/la-000082195oct15.story.

MusicNet and PressPlay

MusicNet is a service formed by AOL Time Warner, Bertelsmann, and EMI, three of the five major record labels.[6] It is designed as a distribution service, through which other online music services will be able to set their own prices and terms.[7] PressPlay was created by the two remaining major labels, Vivendi Universal and Sony, and will be a complete subscription service, dictating to its licensees the price and subscription terms, neither of which have been announced.[8] Since the five labels, combined, control over 80% of all commercial music, and the labels have either bought or sued remaining competitors, MusicNet and PressPlay virtually control the online music industry through the use of its copyrights.[9]

Many analysts give the two online subscription services little chance for early success, given their limitations.[10] MusicNet users can download songs, but can't transfer the files to other devices, like handheld MP3 players and even other computers, while PressPlay won't even give subscribers a file to keep. Neither will have music from all five of the big record companies. And neither will be free.

Department of Justice Antitrust Investigation

Complaints made by online companies of the music industry's practices have made the Department of Justice take a closer look at MusicNet and Pressplay. Following an investigation launched by the European Commission, the DOJ started conducting interviews eight months ago, and has since intensified its examination of the anticompetitive aspects of the digital ventures created by the Big Five, particularly its licensing tactics.[11] Most recently, the DOJ has demanded that the industry organizations and online companies submit a slew of documents relating to Internet music services.[12] The DOJ has started sending out "civil investigative demand letters," hunting for evidence of collusion by record companies and affiliates to impede competition.[13] In

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[6] *See* Clint Boulton, "Justice Department All Ears For Online Music Antitrust Vibe" http://www.internetnews.com/bus-news/article/0,,8161_860531,00.htm.
[7] *See id*.
[8] *See id*.
[9] *See* John Healey, "Antitrust Probe of Music Firms Intensifies" http://www.latimes.com/business/la-000082195oct15.story.
[10] David Bloom, "Industrial Evolution," *The Cleveland Scene*, November 1, 2001.
[11] Dawn Chmielewski, "Justice Department Probes New Online Ventures" http://www.dallasnews.com/entertainment/436540_webmusic_05ove.htm.
[12] *See* John Healey, "Antitrust Probe of Music Firms Intensifies" http://www.latimes.com/business/la-000082195oct15.story.
[13] *See id*.

addition, antitrust investigators are looking at all terms proposed by the record companies and music publishers for their licenses, as well as lawsuits they threatened, filed, or settled over online music.[14] The letters also demand copies of all the proposed and final licenses, any analyses made of the terms, and any documents discussing how much music is needed to launch a successful online business.[15]

Essentially, the DOJ has to prove four factors in an antitrust claim, should it bring a suit against the labels. First, it must show that the labels are a monopolist in control of an essential facility. Second, the competitors of the labels are unable to duplicate the facility. Third, the labels have refused to provide the competitor access, and fourth, that it is feasible for the labels to provide such access.

If the government brings a civil suit against the recording industry, the likely outcome would be either to shut down the two digital distribution services or require that similar licensing structures be offered to independently owned distribution businesses.[16] Some see this as a necessary measure to break up a monopoly and foster competition; others see it as an intrusion on the market in an undeveloped industry. Either way, emotions are high, and labels, lawmakers, artists, and consumers all seem to have an opinion.

A Blatant Monopoly…

The major source of control for the labels is in the copyrights they hold. Since the law does not require a copyright holder to grant a license, the major labels have virtual control over who will get to download music, and on what terms. This has caused a great deal of concern over the labels' use of their copyrights, and competing online music companies have already criticized the labels' tactics, stating that, in effect, MusicNet and PressPlay are entering the online distribution service without any competition.[17] Moreover, many have complained that the labels have refused to negotiate, or have offered licenses at such expensive royalty rates that it would ensure a start-up's bankruptcy.[18] In fact, according to one source, MusicNet is not engaging

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[14] *See id.*
[15] *See id.*
[16] See Brad King, "Music Rights Battle Spins On" http://www.wired.com/news/print/0,1294,47632,00.html.
[17] *See id.*
[18] See Matt Richtel, "Aggressive Strategy Brought On Inquiry of Recording Industry" http://www.nytimes.com/2001.

smaller entities, and even allegedly requires companies to commit to advance payments of as much as $750,000 before entering licensing talks, which is quite an unusual measure.[19]

The result of these joint ventures and the labels' refusal to negotiate with other online companies is that the major labels will effectively be dictating retail prices online.[20] In the traditional marketplace, labels sell the music to wholesalers and have no control over what the retailers charge. In the digital world, the Big Five will be licensing out their music to their own companies, therefore allowing them to control the price, the technology, and the use of the music being downloaded.[21] Right now, their exclusive control of copyright allows them to do this legally.

Online distribution companies as well as trade groups, such as the Digital Media Association, Electronic Frontier Foundation, the National Association of Recording Merchandisers, the Consumer Electronic Association, and lawmakers such as Rick Boucher, D-VA, and Chris Cannon, R-Utah, authors of the Music Online Competition Act, hope that this investigation will allow for more equitable licensing terms and foster open competition.[22]

…Or Appropriate Market Response

Record labels, on the other hand, have stated that they carefully crafted MusicNet and PressPlay with antitrust laws in mind, aware of the potential legal minefield.[23] Moreover, they claim that while they have been cautious in licensing, they have not colluded to limit competition.[24] Says Cary Sherman, general counsel of the Recording Industry Association of America, "The labels are proceeding very cautiously in terms of entry into a brand new marketplace where the business models are uncertain, technological protections are still being developed, and impact on the rest of their businesses unknown."[25]

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[19] Dawn Chmielewski, "Justice Department Probes New Online Ventures" http://www.dallasnews.com/entertainment/436540_webmusic_05ove.htm.

[20] *See* Matt Richtel, "Aggressive Strategy Brought On Inquiry of Recording Industry" http://www.nytimes.com/2001.

[21] *See id*.

[22] *See* John Healey, "Antitrust Probe of Music Firms Intensifies" http://www.latimes.com/business/la-000082195oct15.story.

[23] *See id*.

[24] *See* Clint Boulton, "Justice Department All Ears For Online Music Antitrust Vibe" http://www.internetnews.com/bus-news/article/0,,8161_860531,00.htm.

[25] *See* Matt Richtel, "Aggressive Strategy Brought On Inquiry of Recording Industry" http://www.nytimes.com/2001.

Some policy organizations and lawmakers have given the labels cautious support. Wayne Crews, director of technology studies at the Cato Institute, a libertarian public policy organization, states that collusion may simply be an appropriate market response to the new realities of the digital world.[26] Large businesses are moving their intellectual property online in a very deliberate way to make sure that piracy doesn't undermine their business.[27] Acting too soon may be inappropriate because the market is neither defined nor developed.[28]

Conclusion

While the antitrust investigation is in its early stages and the online music industry is still relatively young, one thing is clear. The Big Five are using their copyrights to control an entire distribution channel – something that is unheard of in the physical world – and are locking up an entire market in an arguably inefficient, sub par manner. The labels' licensing tactics and use of their copyrights, while technically legal, in the words of Judge Marilyn Patel, "look bad, sound bad, smell bad."[29]

By Kelly Donohue

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[26] *See* Brad King, "Music Rights Battle Spins On" http://www.wired.com/news/print/0,1294,47632,00.html.

[27] *See id*.

[28] Dick Kelsey, "Groups Seek Support for Online Music Law" http://www.newsbytes.com/news/01/17236.html.

[29] *See* John Borland, "Napster trial twist: Labels 'smell bad'" http://www.zdnet.com/zdnn/stories/news/0,4586,5098125,00.html.