6 Conclusions

The merger situation

6.1. Under the reference, dated 7 October 1987, we are required to investigate and report whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation under (*inter alia*) section 75 of the Fair Trading Act 1973 (the Act), in that enterprises carried on by or under the control of Chappell & Co Inc (Chappell), of which one at least is carried on in the United Kingdom, will cease to be distinct from enterprises carried on by or under the control of Warner Communications Inc (Warner).

6.2. The reference specified, for the purpose of determining whether or not there was a merger situation qualifying for investigation, the test prescribed in section 64(1)(b) of the Act, generally known as the 'assets test', that is, that the value of the assets taken over exceeded £30 million. The alternative test under section 64(1)(a)—the 'market share test'—was specifically excluded from our consideration by the reference. We have concluded that the assets test has been met.

6.3. The factual situation is a little unusual. As has been mentioned above, the present reference was made on 7 October 1987, when it was the case that arrangements, such as were mentioned in the reference, were in progress or in contemplation. We have been informed that completion of the merger took place on that day. We therefore find, as is consistent with section 75 of the Act, that a merger situation qualifying for investigation has been created, rather than the commoner finding that a situation would be created if these arrangements were carried into effect.

6.4. Having established that a merger situation qualifying for investigation has been created, we have now, under section 69(1)(b) of the Act, to report on whether the creation of that situation operates, or may be expected to operate, against the public interest. Our investigation has been concerned with the effect of the merger so far as the enterprises within the United Kingdom are concerned—and we have noted (see paragraph 1.2) the undertakings which Warner gave to the Secretary of State for Trade and Industry. Bearing in mind the very short time which has elapsed since the merger was completed, we have limited our consideration of the public interest to the second of the statutory alternatives, that is to say, whether the creation of the merger situation may be expected to operate against the public interest.

General observations about the music industry

6.5. Before beginning our assessment of the public interest issues, it is important to emphasise that our inquiry was directed at the Warner/Chappell merger and was not concerned with the United Kingdom music industry in general. It is necessary to recall the scope of the inquiry, because many of those who made representations interpreted our functions as going far wider than these permitted. As a result we had to explain the limits of our terms of reference to a number of those who made representations.

6.6. While we clearly had to exclude from our assessment of the public interest those matters which went beyond the scope of our inquiry, we consider it appropriate to mention the widespread dissatisfaction and unease which we encountered about longstanding arrangements and practices in the music industry and their effects, in particular, on composers and independent publishers. The Warner/Chappell merger, and our inquiry, provided an occasion for ventilating these grievances, in part because fears occasioned by them were exacerbated by the merger.

6.7. These feelings of dissatisfaction, unease and apprehension covered the following matters:

(*a*) the weak bargaining power of composers, especially composers of serious music and those who did not perform their own works, against publishers and users of music, particularly film makers;

(*b*) fears that the power of music user interests would continue to increase and would result in their even larger representation on the governing bodies of the Music Publishers' Association, the Mechanical Rights Society, the Mechanical-Copyright Protection Society, and the Performing Right Society; and that this would act unfairly against the interests of composers and independent music publishers; and

(*c*) a concern that the proposed abolition of the statutory recording licence (SRL), and the related statutory royalty rate, by the Copyright, Designs and Patents Bill at present before Parliament, will operate against the interests of composers and publishers, despite their views to the contrary expressed in consultations before the introduction of the Bill in Parliament.

The case put by opponents of the merger

6.8. The principal arguments put forward by the opponents of the merger (their views are described in detail in Chapter 4 and Appendix 4.2) are:

(*a*) the replacement of the two leading music publishers by a merged organisation would reduce competition, in particular by making entry into music publishing more difficult;

(*b*) because Warner's music-using division would tend to turn to Chappell's copyrights rather than those of independent publishers, such publishers, and their composer clients, would suffer;

(*c*) Warner's music-using division would obtain the use of Chappell copyrights on highly favourable terms to the prejudice of the interests of Chappell's composers;

(*d*) there was an irreconcilable conflict of interest between music users, on the one hand, and publishers (and their composer clients) on the other; and

(*e*) the merger would strengthen the influence of music users on the various music industry regulatory bodies to the long-term detriment of composers and independent publishers.

The Warner/Chappell case

6.9. The principal arguments submitted by Warner/Chappell in answer to criticisms of opponents of the merger are given in detail in Chapter 5. They can be summarised as follows:

(*a*) The merged concern—with approximately a fifth of the United Kingdom market (see paragraph 3.22 and Table 3.2)—will have to face competition from other established music publishers, a number with international affiliations, while the obstacles to the entry into the business of new publishers are not substantial. Composers will, therefore, still have a wide choice of publishers who have to compete to attract composers to use their services; in addition, composers can publish their own works.

(*b*) The integration of music publishing with record production does not distort competition; competition between record businesses is so intense that ownership of a music publisher is irrelevant to their success, just as a connection through common ownership between a record business and a music publisher is irrelevant to the latter's success. Moreover, transactions between music-using and music publishing divisions of Warner/Chappell would be at arm's length. In addition, users of musical copyright are indifferent to its source.

(*c*) There are various institutional and legal safeguards for composers and music publishers.

(*d*) Since the 1960s the bargaining power of composers of popular songs, because they have often been performers, has increased markedly. One indication of this greater bargaining power has been the tendency for the length of time during which composers assign their copyrights to their publishers to shorten, while another has been for composers' shares of income from copyright royalties to increase.

(*e*) The merger will increase efficiency through cost-saving; any redundancies will take place in London.

Public interest issues

6.10. This merger's commercial effects are horizontal as well as vertical. Not only does it bring under common ownership two major United Kingdom publishing businesses, but it also combines a major independent publishing business (Chappell) with a group (Warner) containing users of music as well as music publishing interests. In the following paragraph we therefore identify the possible effects on the various groups of persons affected.

6.11. In connection with this horizontal and vertical integration, we need to consider the following matters affecting the public interest, particularly in respect of competition among the United Kingdom music publishers:

(*a*) the effects on users (other than those which are in-house) of the merged companies' services;

(*b*) the effects on composers (including arrangers), whether or not they were also performers of their own compositions, of the creation of an enterprise with approximately one-fifth of the United Kingdom music publishing market, also operating internationally, and forming part of a group with extensive music-using interests;

(*c*) the effects on independent music publishers;

(*d*) the consequences for the representation of composers and publishers on industry bodies; and

(*e*) the effects on employment.

Effects on users (other than in-house)

6.12. Chappell was not engaged immediately before the merger in record, film or video production, so that the range of independent users and potential users of music for these purposes has not been reduced. The number of 'in-house' users of the services of the combined Warner/Chappell music publishing division remains the same.

6.13. It has been suggested that if the SRL is abolished, Warner/Chappell will try to build up the Warner music-using businesses by withholding Warner/Chappell copyrights from competing users. Warner has denied that it would act in this way, and we do not see any overall commercial advantage in it doing so. Although an important user of music, Warner is just one of a number of such users, and does not dominate the market; in 1986 it held some 13 per cent of the United Kingdom record market (see paragraph 3.27). Attempting to deny access to its catalogue of copyrights to other users would reduce its earnings as a publisher, without necessarily increasing its turnover as a user. To act in this way would also be contrary to Warner's expressed policy of operating its divisions independently. Moreover, such action would hardly escape scrutiny. In addition to the risk of retaliation, criticism within the industry could give rise to bad publicity, and also the possibility of intervention by competition or other public authorities.

Effects on composers

6.14. Although the merger will reduce the number of major music publishers from 13 to 12 (see paragraph 3.19), composers looking for a major publisher will still have a choice between Warner/Chappell and its largest competitors. We do not consider that, for all its size, Warner/Chappell would be able to distort the

market against the interests of composers. There is also a wide range of smaller publishers. Composers, particularly if they have acquired some reputation and standing, can form their own publishing companies.

6.15. Composers of serious music will not be affected by the merger, as Warner does not publish such music, while Chappell's policy for some years has been not to act for serious composers. Paragraph 5.58 explains that Chappell has general rights of exploitation in the works of only one living composer of serious music; in addition, Chappell publishes the works of another under licence from other publishers.

6.16. We have already noted (see paragraph 6.12) that Chappell does not produce films. As a result, in so far as composers are aggrieved at their treatment by certain film producers, these grievances are not affected by this merger.

6.17. We have to consider whether those composer/performers who enter into recording contracts with Warner will come under pressure to appoint Warner/Chappell also as their publisher. No evidence was, however, produced that it was Warner's previous practice to exercise pressure of this kind. Warner pointed out that only four out of 23 composers who had recently signed recording contracts subsequently employed WBM as their publisher. This evidence is consistent with Warner's argument that it is its policy to operate its divisions independently, with inter-divisional transactions being conducted at arm's length (see paragraph 6.9 (b)).

6.18. The most serious allegation of potential damage to the interests of composers which we had to examine was the suggestion that despite the fiduciary obligation owed to a composer by his publisher, the joint Warner/Chappell publishing division would allow the record or other user division to use music of which it held the copyright for an unreasonably low, or even nil, payment in order to minimise or even to avoid making royalty payments to the composer. This would have the effect of increasing the profitability of the group overall at the expense of the composer. Again, no evidence was put forward in support of the fear that Warner/Chappell would behave in this way, and Warner denied that it had ever done so, or would do so. It referred once more to its policy of running all its various divisions separately and for transactions between them to be conducted at arm's length. In addition, each division accounted separately for its financial results.

6.19. In assessing Warner's denial that it would subordinate the interests of the music publishing division to those of the music-using divisions, there were a number of considerations which we took into account. First, as far as Warner's pre-merger businesses in the United Kingdom are concerned—which included parts of the publishing and recording divisions—we note that no consolidated management or group accounts were produced for operations as a whole within the United Kingdom. This tends to corroborate Warner's argument that its policy is to organise its subsidiaries on a divisional basis with, for example, publishing in this country reporting to the United States publishing business. Secondly, it operates a policy of linking a substantial proportion of its management's remuneration to divisional profitability; as a result, management of the publishing division would suffer financially if income properly due to the publishing business were diverted elsewhere. Thirdly, Warner intends to sell a minority interest in the combined worldwide Warner/Chappell publishing business through a flotation in the USA, in accordance with the terms of the agreement under which it acquired Chappell. As a result it would not seem to be in Warner's commercial interests to divert income from the publishing business.

6.20. We recognise that those who alleged that Warner/Chappell's music-using interests would pay less than an arm's length price for Chappell's copyrights were especially concerned about the fate of a particular group of composers: those who did not also receive earnings as performers of their own compositions and who at the same time had long-term (even life plus 50 years) copyright contracts with Chappell. Such composers were likely to be composers of serious music (see

paragraph 21, Appendix 1.1). As we have already pointed out (see paragraph 6.15), it has not been Chappell's policy for many years to act for this type of composer.

6.21. Those who were afraid that the combination of music-using and music publishing interests resulting from this merger would damage the interests of composers already committed to the publishing side of the combined business also argued that the risk would be increased by the prospective abolition by the Copyright, Designs and Patents Bill of the SRL. Such critics, however, overlooked that under existing legislation (the Copyright Act 1956), a music publisher was already free to negotiate with a record producer a royalty for an individual copyright below the rate specified of 6·25 per cent of the retail price of the record (see paragraphs 13 and 14, Appendix 1.1).

The effects on independent music publishers

6.22. As Warner was a music user as well as a music publisher before the merger, the merger does not change the character of its business; it merely increases its size as a publisher. Warner/Chappell is estimated to have approximately one-fifth of the United Kingdom music publishing market, whereas Warner's and Chappell's pre-merger shares were some 10 per cent each (see paragraph 3.22 and Table 3.2). It has been argued that Warner's acquisition of a music catalogue of the size of that held by Chappell will mean that users of music within the enlarged Warner group will be subject to pressure to use Chappell copyrights rather than those held by other publishers. While the increased size of Warner's catalogue of copyright titles would theoretically give it more opportunity to act in that way, we received no evidence to suggest Warner would do so. Warner told us, for example, that those who produce films for Warner will be concerned to choose the most appropriate music for the purpose, rather than to base their choice almost exclusively on availability of copyrights from within the group. Warner's policy of divisional responsibility (see paragraph 6.18) is again relevant.

6.23. We do not consider that the merger of these two major publishers will affect new entry into the music publishing business as there are no formal restrictions to entry, and the existence of the collecting societies eases the process of entry. The main obstacle, in practice, is the need to acquire a reputation which attracts composers.

The consequences for representation of composers and publishers on industry bodies

6.24. A further matter of concern to critics of the merger was that it would increase the representation of the record producers, and of other users of music, on various industry bodies—the PRS, MRS, MCPS, and MPA—to the disadvantage of composers and publishers. There is already some degree of potential or actual imbalance (as between the interests of composers, publishers and users) in the composition of the governing bodies of these organisations (as can be seen from paragraphs 20, 32 and 36 of Appendix 1.1). We have already dealt with matters of disquiet about the state of the music industry which exist (see paragraphs 6.5 to 6.7) irrespective of the merger; the question of fair representation of composer and publisher interests on music industry bodies is one such matter. Chappell's change in status from an independent publisher to an integrated publisher will not significantly alter the present balance of forces within these various governing bodies. We have already pointed out (see paragraph 6.18) that, in addition to its fiduciary responsibility, it is Warner's policy to act at arm's length in its transactions between its music publishing and music-using divisions. The natural consequence of that policy would seem to be that the separation of interests between those divisions would be reflected on those governing bodies on which Warner/Chappell publishing and record divisions were represented.

Effects on employment

6.25. Expected redundancies are small in numerical terms (see paragraphs 5.77 and 5.78). All Warner/Chappell publishing employment is in London, a world centre of the music industry, and it is therefore to be expected that those concerned, particularly if they have specialised experience to offer, will find work with other employers.

Conclusion

6.26. An important feature of this inquiry was the expression by many opponents of the merger of fears that its effect on the music publishing industry would be against the public interest. These fears were, however, unsupported by evidence that such effects were more than a possibility. As was stated in an earlier report of the Commission, 'the question is whether the evidence creates an expectation that the merger will operate against the public interest. To put the matter colloquially, the required conclusion is not " This may happen ", but " We expect that this will happen " '.[1]

6.27. In this case, while the possibility remains of Warner/Chappell misusing such market power as it will possess as the result of the merger, the evidence given to us falls short of establishing the expectation that it will in fact behave in such a way. Moreover, even if Warner/Chappell were to do so in the future, there may well be legal remedies available, both through the courts and through action taken by competition authorities.

6.28. For the reasons given in the two preceding paragraphs, and in the light of our examination in paragraphs 6.12 to 6.25 of the public interest issues listed in paragraph 6.11, we conclude that this merger may not be expected to operate against the public interest.

D G Richards (*Chairman*)

F E Bonner

M B Bunting

D G Goyder

J D Keir

C A Unwin

S N Burbridge (*Secretary*)

6 January 1988

[1] See paragraph 9.40 of a report on the proposed merger of S & W Berisford Ltd and British Sugar Corporation Ltd (HC 241), March 1981.