COMPLETED ACQUISITION BY SONY MUSIC ENTERTAINMENT OF AWAL AND KOBALT NEIGHBOURING RIGHTS BUSINESSES FROM KOBALT MUSIC GROUP LIMITED

CMA Provisional findings report

IMPALA Response dated 4 March 2022

General remarks

IMPALA has reviewed the CMA Provisional findings report (the "Report") and this Response sets out its comments on specific aspects of the Report.

IMPALA has commented below only on those aspects of the Report where it had additions or did not agree the provisional conclusions. A key comment relates to how the two sides of the digital distribution of recorded music interrelate: while closely linked, the competition dynamics of the DSP-facing side are not entirely linked to competition in the artist-facing side of the market and this means that separate competition issues are at play on that side of the market.

The industry

The wholesale distribution of recorded music

At paragraphs 10(c) of the summary, and 2.29 of the full provisional findings in the Report, reference is made to the declining importance of both physical distribution and digital distribution to download.

As IMPALA has commented previously, recorded music in physical formats remains important, and a recorded music company generally still needs to be active in both the physical and the digital recorded music markets in order to be a viable and successful competitor in the market. There remains a segment of customers that can only be reached through the physical market, and there has also been a renewed interest and growth of vinyl in recent years. In addition, the overall decrease in physical revenues over the past years is counterbalanced by a continuous increase of higher margin vinyl sales - which increased by 19.3% between 2020 and 2021 (year-on-year) as well as an increase in CD sales in the UK in late 2021.

Without taking the effect of the physical market on competition in the overall market, and this growth and interest in vinyl in recent years, the CMA will not have a full picture of competition – and competition constraints – in the overall recorded music market. Independent smaller labels tend to "over index" in physical sales, especially vinyl, in comparison to the major labels and as a result their revenues have a greater reliance on the remaining physical sales market.

For the physical market, this includes:

- Visibility in retail outlets. Vinyl sales rely heavily on traditional "bricks and mortar" retail outlets which have limited shelf/racking space so inevitably they are more likely to find room to stock products sold to them by labels that can afford to live with lower margins (i.e. the majors). In consequence, Sony will be likely to focus on its big sellers rather than new, unknown artists that might come through AWAL. This results in a "double whammy" effect – not only do smaller labels struggle to compete for shelf space with the majors, but the loss of these valuable higher margin sales reduces the available revenues to spend on marketing and promotion in the digital sphere. While marketing and visibility in the digital world is key to competition in the music streaming market, clearly visibility and marketing in the physical world such as in retail outlets and of course through live performances, affect competition in the music streaming market.

- Access to manufacturing. In turn, it is difficult to get access to manufacturing, especially for vinyl as production capacity is constrained and a lot of the capacity is already bought up by the majors with greater manufacturing runs, which means smaller runs are more difficult to obtain. Smaller manufacturing orders are also more expensive per unit; as a result, independent labels are unable to achieve the economics of scale available to the majors. The removal of a smaller label from this marketplace only exacerbates the problem.
- We have also heard within our sustainability task force about expected concerns when it comes to access to carbon friendly manufacturing solutions – that will also be a key competition question for the future.

Types of recorded music distribution providers

IMPALA notes that, while paragraph 2.30 of the Report is accurate in setting out the five different possible options open to artists in terms of Provider when releasing music, and while it is easier than ever for artists to upload their music, with an estimated 60,000 tracks being uploaded to Spotify every day, there is still huge demand for the A&R and marketing that a more traditional record company or label supplies. This is because simply being present on a service or multiple music streaming services does not necessary guarantee success. Some artists are able to generate a fan following by themselves, usually using social media, even before being signed to a label. Increasingly, labels want to see a strong existing following before deciding to sign an artist. But it is the labels that bring the best chances of success for new artists and for this reason new artists almost always look to be signed to a label at the earliest opportunity. Labels provide stability, scale, investment, brand, experience, reputation and identity which new artists on their own are unable to replicate.

Moreover, in order to compete in a world in which far greater quantities of music are available to the consumer at the touch of a button, artists need access to the tailored expertise that labels can provide in areas such as digital marketing, licensing, the creation of music videos and artwork, in playlisting creation and optimisation, in data analytics and in reporting and accounting to artists.

This therefore means that options (a)-(c) set out at paragraphs 11 of the summary and 2.30 of the full provisional findings, and the broad deal structures set out in paragraphs 17(a) and (b) of the summary of the Report, remain key in the market, and the Providers that supply these options continue to be key players in the market. This is evidenced by the fact that IMPALA's members and independent labels generally are in more demand than ever from artists.

In this context, a difference between two sets of key operators must be highlighted. The music market is extremely concentrated. Since 2012 it has consisted of 3 multinationals – "the majors" (Sony Music Entertainment, Universal Music Group, Warner Music Group) (since 2012) and thousands of micro-, small or medium sized enterprises – "the independents". The latter are the innovators and early adopters, discovering new talent and producing over 80% of all new releases. The independents are responsible for 80% of the sector's jobs, in line with the average 80% of Europe's jobs generated by SMEs. However, the gap between the independents and the majors is huge. The combined market share of the majors (including distribution) is more than 60%, climbing to a massive 95% for Top 100 on radio in Europe. Even the Top 2000 is concentrated - only 10% is estimated to be coming from independent labels.

The Parties and the Merger

IMPALA agrees that although AWAL was focusing in particular in mid-sized artists, and has been a significant competitor, AWAL appears to have been able to compete at all levels with the majors, as it offered a menu of options at different levels, including more established artists through AWAL Recordings, as acknowledged in the context of the second theory of harm. As explained in our previous submissions, this has been due to the uniqueness of AWAL's service offering as well as the fact that it has grown in scale compared to other companies in the market. Indeed, AWAL was designed to be able to accommodate artists at all stages of their careers, from unsigned and unknown to superstars.

The Counterfactual

Although we understand the reasoning behind the CMA's counterfactual whereby the provisional view is that AWAL would not have been likely to grow its label business materially within the next 2-3 years, whether it had stayed with Kobalt or had been under new ownership as there has been some doubt as to whether AWAL's model and financing was sustainable, that is to ignore the extremely high levels of interest being shown by investors in the recorded music market which grew in 2020 (per IFPI figures) by 7.4% with paid streaming revenues growing 18.5%. It is likely that Kobalt would have been able either to pay down its existing debt or introduce new investment at Kobalt company level. As we explain below, the market for acquisition of music businesses is currently buoyant, and it is quite possible that other buyers may have emerged for AWAL had they not sold to Sony.

Background to the Assessment of Competition

Competition among Providers to sign artists

Competition to identify new artists

IMPALA agrees with the CMA that scouting for new artists is an important aspect of the competitive process. As explained previously and above, the independents are the innovators and early adopters, discovering new talent and producing over 80% of all new releases. Identifying and developing new artists with potential is not only important for independent labels but at the heart of their business models. Unlike the majors, they cannot rely on large back catalogues to sustain them, so they are constantly obliged to seek out and develop new talent. This is a trend which we explain further below.

In this context, IMPALA would like to stress that the concept of "upstreaming" of artists is not limited only to the major labels and A&L services. Independent labels also establish relationships with artists and managers at early stages of an artist's career and may well follow that artist before signing them to a fully-fledged recording agreement by providing low levels of support such as funding individual single releases or EPs or video production in return for an option at a later stage to return to the table to negotiate a broader long-term deal. Upstreaming is a concept used across the industry.

Factors affecting an artist's choice of Provider

IMPALA broadly agrees with the provisional findings of the CMA as regards the factors that affect an artist's choice of Provider set out in paragraphs 6.13-6.15 of the full provisional findings in the Report. As IMPALA has previously argued, for some artists a key factor is the ability to keep their own copyright and there are a limited number of companies that make this possible. Major and independent record labels are less likely to offer retention of copyright deals although it is sometimes possible in the case of well-established artists who are in a position to negotiate such innovative deals. For other artists, who are looking for other offerings from a record company, e.g. the identity and services offered by a major or a large independent, retention of copyright may be less important and other well understood factors listed in paragraphs 6.14 and 6.15 of the Report will take precedence.

This is important as, with 60,000 tracks being uploaded to streaming platforms every day, the ability to compete, particularly for new artists, is much tougher than it used to be, and the ability to bring new music to the attention of consumers is heavily linked to a label's resources and expertise. This benefits the major labels, as artists will be more likely to seek to sign to companies that are able to call upon greater resources to maximise digital opportunities. In short, by taking options out of the market, particularly the innovative option offered by AWAL, artists will be left with few alternatives to the more traditional options offered by the majors.

Competition for label clients

For the sake of clarity, while A&L services providers do compete for label clients, it should be noted as regards paragraphs 6.16-6.19 of the Report that the majors also provide such services, notably distribution, to smaller labels and thus there is also competition between A&L services providers and the majors A&L services arms for label clients in certain areas. As we have explained previously, some smaller independents provide A&R services to artists but are unable to provide either physical or digital distribution services. In this case, they will turn to either aggregators, independent distributors or to the majors' A&L services arms.

Market shares

At paragraph 6.26 of the full provisional findings in the Report, it is noted that care must be taken in interpreting the market share data presented in table 12 for certain reasons. It is stated that some Providers also distribute recorded music on behalf of labels, meaning their share of streams is not representative of their share on the artist-facing side of the market and therefore will be overstated. However, this should not mean that their market share in the market for supplying DSPs should be understated. Both owned and distributed repertoire contribute to the negotiating power of the label with DSPs as labels negotiate deals for both types of repertoire as one package and thus the addition of distributed repertoire will increase that negotiating power. This is particularly the case for the majors, whose A&L services arms provide distribution services to smaller labels.

IMPALA agrees that the significance of certain Providers in the artist-facing side of the market may not be accurately reflected because their lack of deep back catalogues pushes them down the rankings as regards streaming market shares. Nevertheless, many independent labels without the depth of back catalogues of the majors have been able to compete successfully to sign successful new and established artists. Adele, one of the most successful UK artists ever, was signed and developed by a label (belonging to the Beggars Group) with a history that is decades shorter than the major labels. That same independent label was able to compete successfully against the major labels to sign Radiohead.

However, the question of building and retaining catalogue is crucial today, as the revenue generated from catalogue in the music streaming market on the DSP-facing side of the market is significant. Once the term of an artist deal ends, or their rights revert back to them, it becomes more and more difficult for a smaller label to retain that artist and their back catalogue, as they are competing not only with bigger operators like major labels but also venture capital companies and financial investors, who are able and willing to pay high prices to be able to acquire, and exploit the catalogue acquired while not having to invest in artists. Adele was initially signed to an independent label, but when her contract expired, she was signed by Sony which was then able to capitalise on her explosive success created by an independent label. Please see further below how our comments in relation to market shares are also related more generally to our comments on the CMA's approach to defining the market and assessing competition.

The CMA approach to defining the market and assessing competition

The approach to market definition in this case

In both paragraph 32 of the summary and paragraph 6.35 of the full provisional findings in the Report, the statement is made that "[t]he digital distribution of recorded music is a two-sided market where the Providers compete to provide services to artists in order to acquire repertoire which they then compete to distribute to streaming services, i.e. DSPs." Other aspects concerning how the market operates are described in the Report but, as IMPALA sets out in more detail below, the above characterisation does not give a full picture of how the DSP-facing side of the market works, since it suggests that the DSP-facing side is entirely dependent on the artist-facing side of the market or on recruiting artists on that side of the market, which ignores the effect of distribution and the ability to acquire catalogue, and how this affects competition and innovation in the DSP-facing side of the market, including the emergence and development of new DSPs.

The approach to the competitive assessment in this case

The issue of the two sides of the market comes up again in the section (paragraph 6.45 e t seq. of the full provisional findings of the Report) entitled "Approach to the two sides of the market". The CMA, in particular, comes to the provisional view in paragraph 6.47 that:

"Competition between Providers is primarily to attract artists but that is closely linked to competition on the DSP side as it in turn allows Providers to offer an attractive repertoire to DSPs and negotiate favourable terms. These terms feed back into the quality of a Provider's offering to artists both directly (in terms of aspects such as marketing and playlist promotion) and indirectly (through financial terms)."

Again, this is accurate – but only up to a point, since large market players like the majors with large financial resources and market power may add artists to their roster and catalogue i.e. back catalogue to their already vast repertoire by acquiring other smaller players in the market. In addition, the majors have A&L/distribution arms and also add to the overall volume of the repertoire with which they enter into negotiations with DSPs through this route.

As IMPALA has previously argued, a general trend in the market is the gaining of market share by 'attrition'. The majors see that they are in danger of losing market share and identify market share in the shape of DIY and aggregator or distribution solutions (such as The Orchard, Finetunes and Phonofile) as acquisition targets. In Sony's case, its reaction to this situation appears to be to add market share and thus to its negotiating power vis-à-vis DSPs by acquiring smaller and more innovative companies. Investment in smaller labels also carries less risk than new signings. Acquired labels will have a consistency of revenue performance. While a new artist signing may have the potential to provide a greater return, statistically, most new signings are not profitable so larger labels will always seek to "smooth out" the risk profile of their return on investment by making acquisitions which carry less risk.

Role of digital distribution

The provisional findings state that IMPALA submitted that physical formats remained important, some customers can only be reached through them and that there had been renewed interest and growth in vinyl in recent years but that no evidence was presented that considering physical distribution would have any impact on the assessment of the competitive effects of the Merger. We repeat the points that we have made above on this impact (see p.1 - The wholesale distribution of recorded music).

Theories of harm

The CMA has adopted two theories of harm focussing on two areas (paragraph 6.49):

- The overlap between the Parties in the mid-service tier to emerging and established artists and independent labels.
- The extent of competition between AWAL Recordings and SME's frontline labels. The CMA notes that AWAL Recordings provides a high-service tier offering which may be considered an alternative to a frontline label deal for some artists, and notes that it has considered both current and prospective competition for these artists.

In other words, these theories of harm relate only to the artist-facing side of the market, although the DSP-facing side is considered in the context of the second theory of harm as regards high-touch services or AWAL's high-service tier offering to artists. IMPALA comments on this omission in more detail below.

DSPs

In paragraphs 6.47 and 6.58 of the full provisional findings, the CMA explains why it has not adopted a standalone theory of harm as regards the DSP-facing side of the market. It argues that competition on the DSP side takes place primarily through competition for artists as a Provider's strength in competing to supply DSPs is dependent upon recruiting artists who produce music to add to its repertoire (although Providers can also purchase back catalogues, but, the CMA states, this is not an issue relevant to the Merger). Thus, the conclusion of the CMA is that, in order for there to be any Merger-specific effect in relation to the supply of music to DSPs, it would need to arise from a reduction in competition in the provision of services to artists.

As IMPALA has argued above, this conclusion is only partially accurate. This assessment of the competitive dynamics of the market for the supply of music to DSPs appears to ignore the effect of distributed repertoire on the negotiating power of labels, especially the majors, vis-à-vis DSPs. It also ignores the significance of catalogue (again, especially as regards the majors) to that negotiating power. Moreover, it ignores the fact that large market players like the majors with large financial resources and market power may add both artists to their roster and catalogue i.e. back catalogue to their already vast repertoire by acquiring other smaller players in the market.

Thus, in IMPALA's view, it is incorrect to argue that, for there to be any Merger-specific effect in relation to the supply to DSPs, it would need to arise from a reduction in competition in the provision of services to artists since in IMPALA's view it is incorrect to suggest that the downstream supply to DSPs market is *entirely* dependent on competition in the market for the provision of services to artists and the ability to attract artists.

As IMPALA has previously argued, the addition of AWAL to Sony will clearly strengthen Sony through an increment in market share (adding artists, labels distributed by AWAL and catalogue from both to Sony's roster), plus enhance its ability to attract new artists, and that Sony's ability to leverage that increment in its negotiations with DSPs is greater than that of a smaller label due to its already very high market share and large repertoire. Sony's ability to extract better terms from DSPs in turn impacts the deals obtained by the rest of the market, in particular, the independents and other smaller players, and thus ultimately affects consumers, in terms of consumer choice.

Moreover, the loss of AWAL impacts the scale of the independent sector, removing both one of the largest independents and also an innovative independent, which was also a member of Merlin. The loss of such big players from the independent sector thus compounds the competitive impact. In addition, it is likely to affect Merlin's negotiating position in its licensing activities.

In summary, IMPALA considers that the CMA should also have considered a standalone theory of harm as regards the DSP-facing side of the market, given that, while the two sides of the market are closely interlinked, there are clear Merger specific effects in relation to the supply of music to DSPs that do not derive from reduction in competition in the artist-facing side of the market.

Theory of harm: Competitive effects of the Merger: assessment of the impact of the loss of current and potential (future) competition in the supply of A&L services

Current competition and future competition between The Orchard and AWAL

Distinction between artist and label services and implications for current closeness

IMPALA agrees with the CMA's provisional view in paragraph 7.26 of the full provisional findings in the Report that, while there are some differences between artist and label services, there is not a clear distinction and we have previously argued that the distinctions between artist and label services are blurred.

As IMPALA explained in its initial submission of 15.07.21 (the "Submission"), A&R or artist and repertoire services cover the discovery, development and promotion of recording artists, as well as the recording of their music and were traditionally upstream from the wholesale recorded music markets. This distinction has been blurred in recent years, and companies such as AWAL offered services such as distribution services directly to artists while music companies have concentrated to a greater extent on services offered to artists as opposed to traditional music deals. In that context, AWAL has been not only the record label of Kobalt but also an independent distributor. Thus, AWAL has been active in both the A&R and A&L segments.

The CMA points to two factors that drive this closeness in competition between artist and label services: the needs of artist and label customers (which exist on a spectrum); and the capabilities of the Providers (which exist on a spectrum). IMPALA had in particular emphasised the similar nature of services provided by AWAL to artists and labels. The CMA thus considers that it makes sense to consider the closeness of competition between different providers on a case-by-case basis and IMPALA does not disagree.

Current closeness of competition

The CMA's provisional view at paragraph 7.49 appears broadly accurate. As IMPALA has previously noted, it appears that the CMA classified AWAL as being an A&L services provider in its Phase 1 decision but IMPALA considers that the position is more blurred than this and that AWAL was active in both A&L and A&R services. In particular, in contrast to other aggregators, AWAL has been able to provide a high-quality offering and competition, and has put emphasis, as do labels, on the value of music and rights.

AWAL and The Orchard's plans to expand into label and artist services respectively

The CMA provisionally concludes that absent the merger, The Orchard would most likely have become a closer competitor to AWAL in artist services in the foreseeable future. On the other hand, the CMA concludes that AWAL would not have been likely to have become a closer competitor to The Orchard in label services in the foreseeable future, in accordance with its provisional conclusion that AWAL would not have been likely to expand in the next years, unlike The Orchard.

First, as argued in our initial Submission, the market for acquisition of music businesses is currently buoyant. We simply do not know which other buyers may have emerged for AWAL had they not sold to Sony. Kobalt might not have received the same selling price that they obtained from Sony but it is inconceivable that there were no other potential buyers with the ability to invest in AWAL and to expand its label services capabilities.

IMPALA would also like to highlight that this situation illustrates structural competition problems in the music market, which is really a two-speed market, where the distance between top and bottom only continues to increase because only the biggest players are able to continue to grow. While AWAL had succeeded in growing at a faster rate and to reach a scale not achieved by other independent competitors, the question arises as to how much more it might have grown, and could have grown in future, if there were a genuine level playing field in the market.

In considering why AWAL would have not likely been able to expand while The Orchard would, it is important to try to identify the reasons for this trend. AWAL has lost several of its most successful artists to Sony over the past years, which they described at the time as a "financial gut punch" by the company (see comments concerning the recent MBW article on this below). This illustrates a trend where majors - or business such as VC funds or other financial institutions – swoop in to acquire successful artists from independent labels once they have been developed, by-passing the difficult risky years of artist investment and development. We explain this further below under "Changes to SME's frontline model".

Constraint from third party competitors

It is also difficult to understand the conclusion that third-party constraints are sufficient to ensure that rivalry continues to discipline the commercial behaviour of the Parties post-Merger. As explained above, AWAL had succeeded in growing at a faster rate and to reach a scale not achieved by other independent competitors. For those Providers with a market share of at least 1% in 2021, AWAL was the only Provider, outside of the majors' A&L arms, to have experienced positive growth rates over the period 2016-2021 (paragraph 6.29 of the Report). And IMPALA considers that not only do the other majors' A&L arms have dampened incentives to compete in a way to bridge the gap between A&L service providers and the majors, so are they likely to have dampened incentives to compete in a way that undermines the majors' traditional models in the mid-tier of artists and thus to discipline significantly the commercial behaviour of the Parties.

Provisional conclusion

The CMA has come to the provisional view that the Parties were not close competitors in the supply of A&L services as regards the mid-tier of artists, but that, while AWAL was unlikely to have expanded its label services absent the Merger, Sony likely would have done as regards artist services and thus that the Orchard is likely to have become a closer competitor to AWAL in the foreseeable future. Nevertheless, the CMA also found provisionally that, with respect to the Parties' label services activities, a number of strong or moderate constraints will likely remain following the merger. Similarly, in artist services, that there are strong, moderate and weaker third-party constraints. Overall, therefore, the CMA considers that the loss of AWAL is not significant as these third-party constraints are sufficient to ensure that rivalry continues to discipline the commercial behaviour of the parties post-Merger and to prevent an SLC in any market or markets in the UK as a result of current or potential (future) competition in the supply of A&L services.

IMPALA would like to reply to the CMA's provisional conclusion by insisting that in considering why AWAL would have not likely been able to expand while The Orchard would, the CMA needs to identify the reasons for this trend, in particular, the fact that AWAL's growth, while it allowed it to reach a scale that most other independents have not, may well have been greater in the context of a genuine level playing field. In particular, AWAL lost successful artists to Sony, which ultimately then acquired the company. This case illustrates two main problems in the music market: the trend of majors buying shares by attrition, as well as the problem of smaller labels having difficulties retaining catalogue.

The latter is also important as catalogue music represents a significant share of revenues today. In fact, with catalogue representing such an important share of music consumption, IMPALA recommends that the CMA check whether streaming shares are indeed the best available data for assessing market shares for signing artists, where back catalogue plays a lesser role than on the DSP-facing side of the market, as the CMA states in paragraph 8 of its Appendix.

Lastly, while AWAL was maybe not significant for its market share, it was an important alternative to traditional models as it offered a more "unique" model allowing artists to retain their copyright. Therefore, the removal of AWAL does not only mean the loss of one of the biggest independents, but the loss of an innovative model which will ultimately benefit Sony as it may force artists to choose less traditional models which are usually offered by the majors.

In light of this, it is difficult to see how this merger does not have the effect of squeezing independents further in the market. It also seems to confirm the idea that the music market is really a two-speed market where the distance between top and bottom only continues to increase as only the biggest companies are able to continue to grow past a certain level. The CMA should look into the question of how to ensure that the music market develops the features required to enable all players to grow, even the smaller ones.

It is also difficult, therefore, to understand the conclusion that third-party constraints are sufficient to ensure that rivalry continues to discipline the commercial behaviour of the parties post-Merger, given that, outside of the other majors' A&L arms, and as regards Providers with at least 1% market share in 2021, AWAL was the only Provider to have experienced positive growth rates over the period 2016-2021 (paragraph 6.29 of the Report). And as already mentioned above, IMPALA considers that not only do the other majors' A&L arms have dampened incentives to compete in a way to bridge the gap between A&L service providers and the majors, but they are also likely to have dampened incentives to compete in a way that undermines the majors' traditional models in the mid-tier of artists.

Theory of harm: Competitive effects of the Merger: assessment of the impact of the loss of current and potential (future and dynamic) competition in the supply of high-touch services to artists

Changes to SME's frontline model

The CMA's provisional view attributes changes to SME's frontline model to (1) changing technology and (2) the increase in options for artists. IMPALA agrees with the second view – and considers that AWAL in particular has developed in a manner in which to exert a significant and dynamic competition constraint on Sony. IMPALA however believes that the position as regards changing technology is more nuanced.

The CMA notes at paragraph 8.8 of the full provisional findings in the Report that technological advances such as streaming have significantly reduced the risks and costs of music distribution. This is not the case in IMPALA's view. Despite the illusion that the digital market is simpler and less costly, the reality is that labels are more in demand than ever. They also have had to invest heavily in digital businesses to remain not only competitive but also in business.

And, although at face value, the advent of streaming has enabled the reduction of certain costs such as manufacturing and physical distribution, nevertheless the exploitation of recorded music digitally brings with it a number of additional costs. In order to compete in a world in which far greater quantities of music are available to the consumer at the touch of a button, labels must hire and retain the services of personnel experienced in areas such as digital marketing, licensing, the creation of music videos and artwork, in playlisting creation and optimization, in data analytics and in reporting and accounting to artists.

Some of these additional costs will impact competition in the artist-facing side of the market but the majority are key factors relating to competitiveness in the DSP-facing side of the market as they relate to the ability of Providers to negotiate with and market their repertoire to music streaming services.

Further, the core costs of the artist-facing side of the recorded music business remain unchanged: the investment in the signing and development of new artists (co-called "A&R" costs) and in the marketing of their music.

In this context, the larger labels which have the larger resources are able to ensure that their recordings are accorded far greater prominence in key playlists such as "new music Fridays". As a result, access to playlists, which are a vital route to consuming and discovering music in the music market today, is skewed to a significant extent in favour of major record company repertoire (in particular as regards global playlists, despite independents accounting for 80% of new releases annually).

This transparency issue is one of the reasons why IMPALA does not support Spotify's Discovery Mode, which provides for the payment of lower levels of royalties for plays or privileged treatment in algorithms or other features. In addition, these types of "pay to play" arrangements are similar to the system of "payola" once common in the radio broadcast industry.

This also affects competition between DSPs specifically. Although new streaming services emerge every year, very few are successful and none have emerged to challenge the dominance of the larger players such as Apple, Spotify, Google/YouTube and Amazon. Negotiating licence agreements with multiple rights holders, including labels, publishers and collective management organisations is both time consuming and expensive as it requires the engagement of experts such as lawyers experienced in the business of music licensing.

The majors in particular will always insist that any new streaming service pay large upfront advances which few new start-ups are able to afford. The majors have little incentive to encourage the entry of new players into the market when all their repertoire is already available on existing platforms which already have negotiated deals in place with those majors and with whom the majors may have existing vertical relationships. It is clearly in the interest of a major with an equity stake in Spotify not to see Spotify's market share be reduced by a new entrant into the market.

Current competition between AWAL Recordings and SME

We agree with the CMA's provisional view that the evidence above shows that SME has adapted its model in response to A&L services providers. As the CMA notes, AWAL has a history of disruption and the evidence shows that AWAL Recordings provided a credible option and an alternative to a major label deal for some artists and we thus do not consider that the evidence indicates that AWAL Recordings was exercising a relatively limited competitive constraint on SME's frontline offerings pre- Merger. It is difficult to see how this can be the case, if AWAL was a forerunner of a new and dynamic model, which other A&L services providers followed, and to which SME adapted its own model.

The CMA notes that there is also limited evidence that AWAL Recordings is currently perceived as a significant dynamic competitor of SME. In particular, the CMA notes that AWAL Recordings is small. As IMPALA has set out previously, AWAL has had a unique offering consisting of artist ownership and retention of copyrights with high royalty rates. The artists that AWAL signs could equally be signed to Sony or another major, or to a large independent label, and vice versa. This includes competing for the more established artists that have traditionally and typically signed to majors like Sony. We have also previously said that we would expect that AWAL's offering would potentially continue to be 'unique' in terms of its scale outside of the majors, given the scale it has already reached, the means by which it is financed, which, in turn, allows it to make offers to artists of artist ownership and retention of copyrights and high royalty rates.

In addition, the CMA's provisional findings on AWAL's size and the extent of competitive constraint that it represented does not entirely seem in line with its finding that AWAL had in fact reached a certain level of scale not attained by other new market entrants.

Further, it appears that SME's documents do not refer to a meaningful threat to its frontline labels from AWAL and that there is very limited evidence from customers that they considered SME to be an alternative to AWAL. However, at paragraph 8.34 the CMA refers to third party evidence that "the biggest independent artist stories of the last five years (e.g. Lauv, Rex Orange County, girl in red and several more) have all chosen to be represented by AWAL." IMPALA agrees with that view and in its Submission noted examples of artists signed to AWAL such as girl in red but also Little Simz, as well as Thom Yorke, Nick Cave and Moby. Again, given this evidence, it is difficult to understand the CMA's provisional view that AWAL was exercising a relatively limited competitive constraint on SME.

To provide an example as regards just one of those artists, girl in red, Sony is already seeing the benefits of the Merger. The artist has now signed a frontline record deal to Sony's US company, Columbia Records (See Music Business Worldwide). MBW reports that girl in red developed a significant and passionate fanbase in multiple territories, with 12.6 million monthly listeners on Spotify and over 2.1 million subscribers on her YouTube channel, as a priority artist on AWAL. The artist released her debut album, *If I Could Make It Go Quiet*, just one month before the closure of the Merger and that album went Top 10 in the UK (as well as in other music markets, both in Europe and Australia). It also contained the single *Serotin* which was a Top 10 track on Billboard's Rock Airplay chart. Her signing to Columbia Records shows how the AWAL model could be a real asset within Sony. It also means that Sony adds girl in red's existing catalogue, including a Top 10 UK album, to its roster.

Moreover, girl in red is not the only artist lost by AWAL to Sony according to the article – other commercially successful artists who released music through AWAL in the past have subsequently signed to Sony labels e.g. Rex Orange County (RCA) and Madison Beer (Epic Records) (note that Rex Orange County was referred to as another big independent music story in the third-party evidence referred to above). Losing such artists is referred to as a 'financial gut punch' to AWAL in the article.

The above also reinforces the view that independents find it hard to continue to grow past a certain point and compete with majors in the market, given that they spend years (in this case four years) developing an artist, who is then signed by the majors or simply acquired as part of the acquisition of a smaller competitor by a major.

As mentioned above, a classic example of this phenomenon can be seen in the career path of Adele, who was originally signed to XL Recordings, which forms parts of the Beggars group. She made her first three top-selling albums with that independent label, before moving to Sony's label Columbia Records, where she released her new album, 30.

Potential competition (future and dynamic) between AWAL Recordings and SME

The CMA's states that its provisional view is that, under Kobalt's ownership, AWAL would most likely have continued to impose a similar competitive constraint at the higher tiers of its service offering as it had done prior to the Merger, offering a credible option, and for some artists an alternative to a major label deal, through AWAL Recordings and AWAL+. IMPALA sees no reason however why AWAL would not have continued to build on the market share that it had already accrued, to grow it and to expand its business, and the purchase price paid by Sony suggests that it expected AWAL to grow. AWAL is already one of the strongest players in the market for mid-tier artists and this market is expected to grow further in the near future. It could also be expected that some of these artists would in future become established and boost further AWAL's higher tier service offering if the market were a genuine level playing field.

The CMA also raises doubts about the challenges that AWAL Recordings' business model faced regarding its sustainability given the relatively short period over which AWAL Recordings was able to earn a return on its investments. As IMPALA has noted previously, there may be some doubt as to whether AWAL's model and financing was sustainable, and that without this deal Kobalt, and therefore AWAL may not have survived due to Kobalt's high level of debt. However, that is to ignore the extremely high levels of interest being shown by investors in the recorded music market which grew in 2020 (per IFPI figures) by 7.4% with paid streaming revenues growing 18.5%. It is likely that Kobalt would have been able either to pay down its existing debt or introduce new investment at Kobalt company level. As we explained above, the market for acquisition of music businesses is currently buoyant, and we do not know which other buyers may have emerged for AWAL had they not sold to Sony.

Given all of this, and the previous comments that IMPALA has made above about the calibre of artists that have been signed to AWAL to date, IMPALA does not believe that the CMA is correct to conclude that AWAL Recordings would not have offered a materially greater competitive constraint absent the Merger in either static or dynamic terms.

Constraint from third party competitors

The CMA has considered in particular the constraint exercised by third party competitors to AWAL for artists requiring high-touch services since, if they are close competitors to AWAL, they would be expected to exert a similar constraint to AWAL on SME. This appears counter-intuitive, given that the CMA already provisionally concluded that AWAL did not exert a significant competitive constraint on SME. And it is difficult to understand how, collectively, they exercise at least as strong a constraint on SME as AWAL, if one of them was exercising a similar level of constraint to AWAL (which the CMA concludes provisionally was not significant), while the two others exercised a lower level of constraint. The argument here appears to be somewhat circular.

IMPALA however agrees with the CMA provisional view that the major owned A&L providers ADA and Virgin are likely to have somewhat dampened incentives to compete in a way which could contribute to bridging the gap between A&L services providers and the majors. IMPALA thus sees the competitive constraint exerted by them as limited.

Impact of consolidation on the DSP-facing side

As IMPALA has argued above, the CMA appears to consider that competition in the DSP-facing side of the market is entirely dependent on competition in the upstream segment of the market for A&R services. This ignores first the influence of back catalogue on competition in the market for the supply of music to DSPs, which is key. By acquiring AWAL, Sony is not merely acquiring AWAL's ability and business of attracting artists, and adding both artists and labels to its roster, but also a new chunk of catalogue to the vast repertoire that it holds i.e. the catalogue that AWAL has already acquired through artists signed to it, and the catalogue that it distributes on behalf of other labels. It is thus incorrect to characterise competition between providers as being primarily to attract artists in order to be able to offer an attractive repertoire to DSPs: this is only one aspect of competition in the DSP-facing side of the market.

It is also important to emphasise that through this deal, Merlin lost a significant member, and even though Merlin acts to increase competition in the market (by amongst other things reducing the monopolistic power of the majors), some streaming services still appear to refuse to engage in a collective licensing discussion with Merlin, a problem that will only be exacerbated by Sony's acquisition of AWAL.

Conclusion

In conclusion, IMPALA's comments on the Report can be summarised as follows:

The industry

- IMPALA considers that without taking into account the effect of the physical market on competition in the overall market, and the growth and interest in vinyl in recent years, the CMA will not have a full picture of competition – and competition constraints – in the overall recorded music market.
- Even in the context of the digital market, there is still huge demand for the A&R and marketing services that a more traditional record company or label supplies. This is because simply being present on a service or multiple music streaming services does not necessary guarantee success. As a result, the key Providers in the market for the wholesale distribution of recorded music remain those who provide artist services, whether these are more traditional record companies or A&L services providers.

The Parties and the Merger

- While AWAL was focusing in particular in mid-sized artists, and has been a significant competitor in that tier, AWAL appears to have been able to compete at all levels with the majors, as it offered a menu of options at different levels, including more established artists through AWAL Recordings.

The Counterfactual

- The provisional conclusion that AWAL would not have been likely to grow its label business materially within the next 2-3 years, whether it had stayed with Kobalt or had been under new ownership (given doubts as to the sustainability of AWAL's business model and financing) appears to ignore the current extremely high levels of interest being shown by investors in the recorded music market.

Background to the assessment of competition

- As regards market shares, IMPALA agrees that care must be taken in interpreting the data presented in table 12. Some Providers also distribute recorded music on behalf of labels, meaning their share of streams is not necessarily representative of their share on the artist-facing side of the market and therefore may be overstated. However, the position in the market for supplying DSPs will be different because both owned and distributed repertoire contribute to the negotiating power of the label with DSPs as labels negotiate deals for both types of repertoire as one package and thus the addition of distributed repertoire will increase that negotiating power of a Provider on that side of the market.
- The characterisation of the interrelationship between the two sides of the market for the digital distribution of music in the Report is not correct. It does not paint a full picture of how the DSP-facing side of the market works, since it suggests that the DSP-facing side is ***entirely*** dependent on the artist-facing side of the market or on recruiting artists on that side of the market. This ignores the effect of distribution and of distributed catalogue on negotiating power. It also ignores the ability to acquire catalogue, as Sony has done. In turn, these factors affect competition and innovation in the DSP-facing side of the market, including the emergence and development of new DSPs.

Theories of harm

- Given the above, IMPALA considers that the lack of a standalone theory of harm relating to the DSP-facing side of the market is an omission because, while the two sides of the market are closely interlinked, there are clear Merger specific effects in relation to the supply of music to DSPs, which are not connected to the reduction in competition in the artist-facing side of the market.

1. Competitive effects of the Merger: assessment of the impact of the loss of current and potential (future) competition in the supply of A&L services

- IMPALA broadly agrees with the CMA's provisional conclusions concerning current closeness of competition between the Parties but does not share the CMA's view concerning the likely future expansion of AWAL, because other sources of financial investment (absent Sony) could not be ruled out given the current buoyancy of the market for the acquisition of music companies. Moreover, if these conclusions were accurate, it would simply illustrate IMPALA's concerns about structural competition problems in a two-speed market in which even the strongest independents find it difficult to continue to grow past a certain scale.
- It is also difficult to understand the conclusion that third-party constraints are sufficient to ensure that rivalry continues to discipline the commercial behaviour of the parties post-Merger, given that, outside of the other majors' A&L arms, as regards Providers with at least 1% market share in 2021, AWAL was the only Provider to have experienced positive growth rates over the period 2016-2021 (paragraph 6.29 of the Report), and given the reduced incentives of the majors' A&L arms to compete in a manner to disrupt traditional models.

2. Competitive effects of the Merger: assessment of the impact of the loss of current and potential (future and dynamic) competition in the supply of high-touch services to artists

- IMPALA considers that, contrary to the CMA's assessment, the key factor influencing changes to SME's frontline model has been the increase in options for artists, as opposed to both that and technology changes combined. Although, at face value, the advent of streaming has enabled the reduction of certain costs such as manufacturing and physical distribution, nevertheless the exploitation of recorded music digitally brings with it a number of additional costs. In order to compete in a world in which far greater quantities of music are available to the consumer at the touch of a button, labels must hire and retain the services of personnel experienced in areas such as digital marketing, licensing, the creation of music videos and artwork, in playlisting creation and optimisation, in data analytics and in reporting and accounting to artists. Yet the key A&R services remain the same.
- IMPALA does not consider that the evidence indicates that AWAL Recordings was exercising a relatively limited competitive constraint on SME's frontline offerings pre-Merger nor that it was not a significant dynamic competitor. IMPALA's view is borne out by a key piece of third-party evidence to which the CMA refers itself, by the calibre of artists that were signed by AWAL Recordings, and by the benefits that Sony is already reaping from the Merger in relation to at least one of those key high-tier artists.
- IMPALA's view is also borne out by the scale that AWAL had reached compared to other independents and by the fact that it was, according to the market share evidence, the only Provider with at least 1% market share in 2021 outside of the majors to have to have

experienced positive growth rates over the period 2016-2021 (paragraph 6.29 of the Report).

- Further, IMPALA does not believe that the CMA is correct to conclude that AWAL Recordings would not have offered a materially greater competitive constraint absent the Merger in either static or dynamic terms or that future expansion of AWAL was unlikely: other sources of financial investment (absent Sony) could not be ruled out given the buoyancy of the market for the acquisition of music companies.
- It is also difficult to understand how, collectively, the remaining third-party competitors exercise at least as strong a constraint on SME as AWAL, if one of them was exercising about the same level of constraint as AWAL (which the CMA concludes provisionally was not significant), while the two others exercised a lower level of constraint. Moreover, in relation to other possible competitors, the major owned A&L providers, ADA and Virgin, the CMA concluded that they are likely to have somewhat dampened incentives to compete in a way which could contribute to bridging the gap between A&L services providers and the majors. IMPALA thus sees the competitive constraint exerted by the latter as limited.
- Finally, as regards the conclusions concerning the impact of consolidation in the DSP-facing side of the market, we repeat our comments concerning the apparent misunderstanding as regards the competitive dynamics on that side of the market.