File No. CT-2015-

COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act,* R.S.C. 1985, c. C-34 (the "**Act**");

AND IN THE MATTER OF an application by Stargrove Entertainment Inc. for an order pursuant to section 103.1 of the Act granting leave to bring an application under sections 75, 76, and 77 of the Act;

AND IN THE MATTER OF an application by Stargrove Entertainment Inc. for an order pursuant to sections 75, 76, and 77 of the Act;

AND IN THE MATTER OF an application by Stargrove Entertainment Inc. for an order pursuant to section 104 of the Act;

BETWEEN:

STARGROVE ENTERTAINMENT INC.

Applicant

- and -

UNIVERSAL MUSIC PUBLISHING GROUP CANADA,
UNIVERSAL MUSIC CANADA INC.,
SONY/ATV MUSIC PUBLISHING CANADA CO.,
SONY MUSIC ENTERTAINMENT CANADA INC.,
ABKCO MUSIC & RECORDS, INC.,
CASABLANCA MEDIA PUBLISHING, and
CANADIAN MUSICAL REPRODUCTION RIGHTS AGENCY LTD.

Respondents

PROPOSED NOTICE OF APPLICATION

(under ss. 75, 76, and 77 of the *Competition Act*)

TAKE NOTICE THAT:

1. The Applicant will make an application to the Competition Tribunal ("**Tribunal**") pursuant to sections 75, 76, and 77 of the *Competition Act* (the "**Act**") for:

(a) an Order pursuant to section 75(1) of the Act requiring the Respondents to accept the Applicant as a customer within 15 days of the Tribunal's order, on the same standard trade terms applicable to other applicants to the Canadian Musical Reproduction Rights Agency Ltd. ("**CMRRA**");

(b) an Order pursuant to section 76(2) of the Act prohibiting the Respondents from continuing to engage in the practices that form the basis of this Application;

(c) an Order pursuant to section 76(2) of the Act requiring the Respondents to accept the Applicant as a customer within 15 days of the Tribunal's order, on the same standard trade terms applicable to other applicants to CMRRA;

(d) an Order pursuant to section 76(8) of the Act prohibiting the Respondents from continuing to engage in the practices that form the basis of this Application;

(e) an Order pursuant to section 76(8) of the Act requiring the Respondents to accept the Applicant as a customer within 15 days of the Tribunal's order, on the same standard trade terms applicable to other applicants to CMRRA;

(f) an Order pursuant to section 77(2) of the Act prohibiting the Respondents from continuing to engage in exclusive dealing;

(g) an Order pursuant to section 77(2) of the Act requiring the Respondents to accept the Applicant as a customer within 15 days of the Tribunal's order, on the same standard trade terms applicable to other applicants to CMRRA;

(h) an Order expediting the hearing of the within Application;

(i) an Order for costs, if the within Application is opposed; and

(j) such further and other orders as the Applicant may request and the Tribunal deems just.

AND TAKE NOTICE THAT:

2. The persons against whom the orders are sought are the Respondents: Universal Music Publishing Group Canada; Universal Music Canada Inc.; Sony/ATV Music Publishing Canada Co.; Sony Music Entertainment Canada Inc.; ABKCO Music & Records, Inc.; Casablanca Media Publishing; and Canadian Musical Reproduction Rights Agency Ltd. The Respondents' addresses are set out below.

3. The Applicant will rely on the Statement of Grounds and Material Facts attached as Schedule "A" hereto; the Affidavit of Terry Perusini, sworn August 26, 2015; the Affidavit of Mario Bouchard, sworn August 27, 2015; and such further and other grounds and material facts as counsel may advise and the Tribunal may permit.

4. A concise statement of the economic theory of the case is contained in Schedule "B" hereto.

5. The Applicant requests that the within Application be heard in the English language.

6. The Applicant requests that the documents for this Application be filed in electronic form.

DATED at Toronto this 28th day of August, 2015

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AND TO: **Universal Music Canada Inc.**
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PART 1 - THE APPLICATION IN A NUTSHELL

1. Stargrove is a record label that manufactures CD compilations of sound recordings of The Beatles, The Rolling Stones, and other artists for sale at low prices ($5.00) at Walmart stores. It can offer such low prices because the sound recordings it uses are no longer protected by copyright; they are in the public domain. As such, Stargrove does not require a "master sound recording licence" to use the recordings.

2. Although the sound recordings are in the public domain, the musical works (songs) on the recordings continue to be copyright protected. Stargrove requires what are known as "mechanical licences" for each song it seeks to use. In Canada, there are standard industry practices and terms that govern the issuance of mechanical licences; for the songs relevant to this application, these are administered by the Canadian Musical Reproduction Rights Agency. Stargrove is willing to abide by those terms and practices. The Respondents, however, have banded together to shut Stargrove out, having CMRRA deny Stargrove <u>any</u> mechanical licences (not just for the titles in question).

3. Stargrove is being targeted for its low pricing model, but the real victims are consumers; instead of being able to buy popular titles for just $5.00 per CD, they pay much more.

4. The Respondents have campaigned to block Stargrove by pressuring Stargrove's distributor, concocting false negative reviews of Stargrove's CDs, and having CMRRA refuse to deal with Stargrove on standard terms. They have violated sections 75, 76, and 77 of the Competition Act, depriving consumers of competitive prices and artificially extending copyright over public domain recordings. This has negatively affected competition. Stargrove seeks to be treated fairly, in accordance with standard industry terms. Since the Respondents are unwilling to engage with Stargrove, Stargrove asks this Tribunal to order them to do so.

PART 2 - FACTS

A. The Parties

5. The Applicant, Stargrove Entertainment Inc. ("**Stargrove**"), is a company incorporated in July 2014 under the laws of Ontario. Stargrove is a record label in the business of manufacturing and selling competitively-priced musical compact discs ("**CDs**").

6. The Respondents Sony/ATV Music Publishing Canada Co. and Sony Music Entertainment Canada Inc. (collectively, "**Sony**") and Universal Music Publishing Group Canada and Universal Music Canada Inc. (collectively, "**Universal**") are music publishing companies and record labels located in Toronto, Ontario. The Respondent Casablanca Media Publishing ("**Casablanca**") is a music publishing company located in Toronto. The Respondent ABKCO Music and Records Inc. ("**ABKCO**") is a record label, music publisher, and film and video production company headquartered in New York, New York.

7. The Respondent Canadian Musical Reproduction Rights Agency Ltd. ("**CMRRA**") is a music licensing collective representing music publishers. On behalf of music publishers, CMRRA issues licences for the reproduction of musical works on various media, including mechanical licensing for the reproduction of songs on CDs.

8. Sony, Universal and Casablanca are represented by CMRRA and have representatives on the Board of Directors of CMRRA. ABKCO is represented by CMRRA but, to Stargrove's knowledge, does not have representatives on its Board of Directors.

9. Anderson Merchandisers Canada Inc. ("**Anderson**") (which is not a party to the case) distributes CDs to major Canadian retailers, including Walmart and BestBuy. Anderson

is the exclusive distributor for CDs in Walmart in Canada and is the distributor for Stargrove's CDs.

B. Licensing Musical Works in Canada

10. For the purposes of this Application, there are two copyrights that matter:

    (1) The copyright in the musical work. In order to reproduce a musical work, a party must obtain a "**mechanical licence**" from the holder of the copyright in the musical work, if the work is protected by copyright. If the work has fallen into the "**public domain**", no licence is required to use the work.

    (2) The copyright in the master sound recording. In order to reproduce the sound recording on which a musical work is fixed, a party must obtain a "**master recording licence**" from the holder of the copyright in the sound recording. If the sound recording has fallen into the public domain, no licence is required to use the sound recording.

11. Stargrove's business is to manufacture and sell CDs. Its current business activity is to manufacture and sell CDs of musical works whose sound recordings are in the public domain. In order to do so, Stargrove needs to obtain mechanical licences for the works, but does not need to obtain master recording licences. Stargrove then manufactures and sells these CDs at very competitive prices.

12. Although a record label in Stargrove's position can seek to obtain a mechanical licence directly from the copyright holders, the common practice in Canada is for a record label to apply for mechanical licences from CMRRA, which is the authorized representative for most musical work copyright holders in Canada. For a record label of Stargrove's size,

the typical way to obtain such mechanical licences is by entering into a mechanical licence agreement ("**MLA**") with CMRRA. A record label that has signed an MLA obtains mechanical licences on standard terms and at standard rates.

13. The standard mechanical royalty rate in Canada is currently $0.083 per song, per copy (for recordings with a running time of five minutes or less). Applications to CMRRA are granted as a matter of course at this standard rate. CMRRA's contracts with the publishers it represents (called "**Affiliation Agreements**") contemplate that CMRRA "shall" issue the mechanical licences on standard terms, unless the publisher decides that it wants to deal directly with the record label to issue the licence.

14. In practice, the market for the issuance of mechanical licences operates as though it were a compulsory system. The process is so automatic that record labels almost always produce CDs even before they have obtained mechanical licences. Royalties owed on these CDs are held pending the identification of the copyright owner.

C. Stargrove's Business Was Immediately Successful

15. In January 2015, Stargrove made an application to CMRRA for mechanical licences for five titles (collectively, the "**Titles**"): The Beatles *Love Me Do*, The Beatles *Can't Buy Me Love*, The Rolling Stones *Little Red Rooster*, Bob Dylan *It Ain't Me Babe* and The Beach Boys *Fun, Fun, Fun* (each of these titles is a compilation of 11 songs).

16. For each of these titles, copyright in the musical work still exists (hence the need for a mechanical licence), but copyright in the sound recording has expired. As such, the sound recording is in the public domain, meaning that the public has the right to use and copy that recording without permission.

17. With its mechanical licence application to CMRRA, Stargrove submitted the required royalty payment of $13,799.10.

18. CMRRA cashed Stargrove's cheque and Stargrove began producing its CDs for sale. The CDs went on sale in Walmart on February 3, 2015 for a retail price of $5.00. In the first week of sales, The Beatles' *Love Me Do* was Walmart's top-selling CD, with 1,488 copies sold in one week alone.

D. The Respondents Ordered CMRRA to Stop Issuing Stargrove Mechanical Licences

19. The publishers associated with each of the Titles include ABKCO, Casablanca and Sony (collectively, the "**Title Holders**"). One by one, and in quick succession, each of the Title Holders gave instructions to CMRRA in January or February 2015 to stop issuing mechanical licences to Stargrove.

20. A CMRRA representative professed her surprise to Stargrove at this instruction from the Title Holders, but CMRRA followed their instruction. In fact, CMRRA went even further and refused to grant Stargrove *any* mechanical licences, whether from one of the Title Holders or not. Stargrove's attempts to enter into an MLA were stymied by CMRRA, who erected barrier after barrier to Stargrove's application.

21. CMRRA refunded Stargrove's royalty payment for the Titles at the end of February 2015.

22. On multiple occasions, Stargrove requested explanations for the refusals to grant mechanical licences, both from CMRRA and from the Title Holders directly, and asked them to reverse course. Stargrove has been refused an explanation, other than in a letter from CMRRA, which stated that the Title Holders' "refusal to deal is at least partially related to the fact that there are public domain master recordings on the products in question."

23. The Title Holders are withholding mechanical licences in order to artificially extend copyright over recordings that should be in the public domain. They are doing so in direct response to the legitimate competition that Stargrove was bringing to the market. As set out above, some Title Holders have record label divisions, while others are affiliated with record labels. They do not like Stargrove's pricing model and the fact that Stargrove was able to gain market share so quickly.

E. Universal Tried to Prevent or Harm Stargrove's Business

24. Randy Lennox, the CEO of Universal Music Canada Inc., sent an e-mail to the principals of Anderson, the distributors of Stargrove's CDs, asking Anderson to partner with Universal to find solutions and resolve what he called a "public domain issue".

25. Brian Greaves, an account manager at Universal Music Canada Inc., concocted negative reviews on Walmart's website, complaining that Stargrove's products were of poor quality. He encouraged other Universal employees to do the same and to help him with Universal's "campaign" to discourage Anderson from distributing Stargrove's CDs, stating that poor reviews would deter Anderson from distributing Stargrove's products in the future. Walmart subsequently removed all the fake reviews from its site. Stargrove's CDs had a low return rate: of the over 2000 Stargrove CDs sold, only one CD was returned.

26. Mr. Greaves noted that Stargrove's CDs were taking away from Universal's sales and market share, and claimed that Universal had already successfully removed a Rolling Stones title from the CDs offered for sale by Stargrove, despite the fact that the copyright in question was held by ABKCO, not Universal.

F. The Respondents Campaigned to Shut Stargrove Out

27. The Respondents mean to punish Stargrove for its low pricing and ability to compete with established record labels. Ultimately, this keeps the prices of CDs high. The decision to instruct CMRRA to refuse to issue mechanical licences to Stargrove surprised even the employees of CMRRA.

28. Since Stargrove has been shut out of the market, it has missed out on several lucrative opportunities to market its CDs, resulting already in an estimated loss of $150,000 in wholesale sales. Anderson wanted approximately 20,000 copies of Beatles CDs that Stargrove would have otherwise produced. Anderson continues to identify marketing opportunities for Stargrove through Walmart that Stargrove is unable to pursue because of CMRRA's and the Respondents' refusal to issue it mechanical licences. As recently as three weeks ago, Anderson identified a lack of stock of Beatles and Rolling Stones CDs; it wanted Stargrove to help it fill its orders. Stargrove cannot do so, as long as it is being unfairly and unlawfully blocked from the market.

29. Stargrove's CDs have been pulled from Walmart's shelves, and its sales – given that it can obtain no mechanical licences from CMRRA – are now zero.

PART 3 - GROUNDS FOR THE SECTION 75, 76, AND 77 APPLICATION

30. The Respondents' conduct violates sections 75, 76, and 77 of the Act.

31. Stargrove has been directly affected by the Respondents' conduct. By refusing to deal with Stargrove and forcing CMRRA not to deal with Stargrove, the Respondents are preventing Stargrove from entering the market and from having the competitive impact that was observed in the short time that Stargrove was able to sell CDs. Without being able to obtain mechanical licences through CMRRA, Stargrove will go out of business.

A. Refusal to Deal (Section 75(1))

32. Section 75(1) of the Act sets out the requirements for the reviewable trade practice of refusal to deal:

> *Jurisdiction of Tribunal where refusal to deal*
>
> 75. (1) Where, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that
>
> (*a*) a person is substantially affected in his business or is precluded from carrying on business due to his inability to obtain adequate supplies of a product anywhere in a market on usual trade terms,
>
> (*b*) the person referred to in paragraph (*a*) is unable to obtain adequate supplies of the product because of insufficient competition among suppliers of the product in the market,
>
> (*c*) the person referred to in paragraph (*a*) is willing and able to meet the usual trade terms of the supplier or suppliers of the product,
>
> (*d*) the product is in ample supply, and
>
> (*e*) the refusal to deal is having or is likely to have an adverse effect on competition in a market,
>
> the Tribunal may order that one or more suppliers of the product in the market accept the person as a customer within a specified time on usual trade terms unless, within the specified time, in the case of an article, any customs duties on the article are removed, reduced or remitted and the effect of the removal, reduction or remission is to place the person on an equal footing with other persons who are able to obtain adequate supplies of the article in Canada.

33. Stargrove is substantially affected in its business and precluded from carrying on its business due to its inability to obtain the right from the Respondents to reproduce songs on usual trade terms (through mechanical licences).

34. Stargrove is unable to obtain these rights because the mechanical licences at issue are in the sole control of the Respondents.

35. Stargrove is willing to meet the usual trade terms of the Respondents through CMRRA for issuing mechanical licences. It has tried to enter into CMRRA's standard MLA, but CMRRA refuses to deal with it on its standard terms.

36. The granting of rights to reproduce songs is not limited in supply – as noted above, mechanical licences are normally granted as a matter of course.

37. The Respondents' refusal to deal is having an adverse effect on competition in the market for CDs in Canada, specifically in respect of popular music whose sound recordings are in the public domain. The consuming public, whose purchase decisions made Stargrove's CDs top sellers in their first week of sales, is being denied the low-cost alternative that Stargrove seeks to provide.

38. Stargrove therefore submits that the Respondents' refusal to deal satisfies all the elements of s. 75 of the Act and respectfully requests that the Tribunal make an order under s. 75 of the Act requiring the Respondents to accept Stargrove as a customer within 15 days of the Tribunal's order, on the same standard trade terms applicable to other applicants to CMRRA.

B. Price Maintenance (Section 76)

39. The Respondents' conduct violates s. 76 of the Act, which states, in part:

> *Price maintenance*
>
> 76. (1) On application by the Commissioner or a person granted leave under section 103.1, the Tribunal may make an order under subsection (2) if the Tribunal finds that
>
> (*a*) a person referred to in subsection (3) directly or indirectly
>
> …
>
> (ii) has refused to supply a product to or has otherwise discriminated against any person or class of persons engaged in business in Canada because of the low pricing policy of that other person or class of persons; and
>
> (*b*) the conduct has had, is having or is likely to have an adverse effect on competition in a market.
>
> …

Persons subject to order

(3) An order may be made under subsection (2) against a person who

(*a*) is engaged in the business of producing or supplying a product;

… or

(*c*) has the exclusive rights and privileges conferred by a patent, trade-mark, copyright, registered industrial design or registered integrated circuit topography.

Refusal to supply

(8) If, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that any person, by agreement, threat, promise or any like means, has induced a supplier, whether within or outside Canada, as a condition of doing business with the supplier, to refuse to supply a product to a particular person or class of persons because of the low pricing policy of that person or class of persons, and that the conduct of inducement has had, is having or is likely to have an adverse effect on competition in a market, the Tribunal may make an order prohibiting the person from continuing to engage in the conduct or requiring the person to do business with the supplier on usual trade terms.

40. The Respondents fall under both s. 76(3)(a) and (c), as they are engaged in the business of supplying rights to reproduce musical works (through mechanical licences), and they have the exclusive rights and privileges conferred by the copyright in the musical works associated with the mechanical licences.

41. The Respondents' conduct falls within s. 76(1)(a)(ii) because they have refused to supply a product to Stargrove. Specifically, the Respondents have refused to grant Stargrove the right to reproduce musical works in an attempt to keep Stargrove from competing in the market for CDs where the sound recordings are in the public domain. The Respondents are doing so because Stargrove's low pricing policies were going to disrupt the CD market and take away market share from the record labels.

42. The Respondents have also acted contrary to s. 76(1)(a)(ii) because they have "otherwise discriminated against" Stargrove. The Respondents have discriminated against Stargrove by denying it access to the right to reproduce musical works (through

mechanical licences and an MLA) and by refusing to deal with it on terms similar to the terms that would apply to any other record label. This discrimination arises because of Stargrove's low pricing policy. E-mails from executives at Universal identify that the refusal to supply and discriminatory treatment occurred because Stargrove's $5.00 CDs were gaining market share.

43. The Respondents have also acted contrary to s. 76(8) by inducing CMRRA, as a condition of doing business with the Respondents, to refuse to supply the relevant rights (through mechanical licences and an MLA) to Stargrove. This refusal arises because of Stargrove's low pricing policy.

44. The Respondents' refusal to supply has impeded Stargrove's entry into and expansion in the CD market in Canada and has resulted, and is likely to result, in a substantial lessening or prevention of competition, as consumers are being denied access to the low-cost CDs they want.

45. Stargrove therefore respectfully requests that the Tribunal make orders pursuant to ss. 76(2) and 76(8) of the Act **(1)** prohibiting the Respondents from continuing to engage in price maintenance and **(2)** requiring the Respondents to accept the Applicant as a customer within 15 days of the Tribunal's order, on the same standard trade terms applicable to other applicants to CMRRA.

C. Exclusive Dealing (Section 77)

46. The Respondents' conduct is in violation of s. 77 of the Act.

47. Subsection 77(1) defines "exclusive dealing" as:

> (*a*) any practice whereby a supplier of a product, as a condition of supplying the product to a customer, requires that customer to

> (i) deal only or primarily in products supplied by or designated by the supplier or the supplier's nominee, or
>
> (ii) refrain from dealing in a specified class or kind of product except as supplied by the supplier or the nominee, and
>
> (*b*) any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (*a*)(i) or (ii) by offering to supply the product to the customer on more favourable terms or conditions if the customer agrees to meet the condition set out in either of those subparagraphs

48. Subsection 77(2) provides:

> (2) Where, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely to
>
> (*a*) impede entry into or expansion of a firm in a market,
>
> (*b*) impede introduction of a product into or expansion of sales of a product in a market, or
>
> (*c*) have any other exclusionary effect in a market,
>
> with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in that exclusive dealing or tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.

49. The Respondent publishers and CMRRA are major suppliers of rights to reproduce musical works (through mechanical licences and MLAs) in Canada.

50. Universal pressured Anderson not to deal with Stargrove, offering veiled incentives and making veiled threats to deter Anderson from dealing with Stargrove and posting false online reviews in order to influence Anderson and others away from Stargrove.

51. The Respondents' exclusive dealing has impeded Stargrove's entry into and expansion in the CD market in Canada.

52. The Respondents' exclusive dealing has resulted, and is likely to result, in a substantial lessening of competition, as consumers are being denied access to CDs they want at low prices.

53. Stargrove therefore respectfully requests that the Tribunal make orders under s. 77(2) of the Act **(1)** prohibiting the Respondents from continuing to engage in exclusive dealing; and **(2)** requiring the Respondents to accept the Applicant as a customer within 15 days of the Tribunal's order, on the same standard trade terms applicable to other applicants to CMRRA.

54. In support of this Application, and the Grounds and Material Facts set out above, Stargrove relies on:

(a) the affidavit of Terry Perusini, sworn August 26, 20015;

(b) the affidavit of Mario Bouchard, sworn August 27, 2015;

(c) the *Competition Act*, RSC 1985, c C-34, as amended, including ss. 75, 76, 77 and 103.1;

(d) the Competition Tribunal Rules, SOR/2008-141; and

(e) such further and other grounds and material facts as counsel may advise and the Tribunal may permit.

SCHEDULE "B" – CONCISE STATEMENT OF THE ECONOMIC THEORY OF THE CASE

1. This schedule provides a concise statement of the economic theory that supports the Application requesting that the Tribunal[1] issue orders pursuant to sections 75, 76 and 77 of the Act.

2. The conduct of the Respondents, in respect of their refusal to provide the right to reproduce musical works (by way of mechanical licences and an MLA on standard terms), is not a mere exercise of intellectual property rights or of market power. This statement of economic theory identifies why the refusals increase market power and harm competition.

3. The relevant geographic market is Canada, given the Federal statutory framework that applies to copyright and that prices are unlikely to vary across the country for a given retailer.

4. The relevant product market, i.e., where competition is harmed, is in the wholesale sale of CDs containing popular music titles recorded before 1964 and that have three characteristics: (i) the sound recording being marketed is in the public domain; (ii) the musical work fixed on the sound recording remains protected by copyright; and (iii) the recordings are of performances by artists who continue to be popular. Examples include the performers of the titles at issue in this application, including The Beatles, The Rolling Stones, and The Beach Boys.

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[1] This schedule adopts the definitions set out in the Notice of Application and Statement of Grounds and Material Facts.

5. The effect of the refusal is reflected in retail prices. The effect of the refusal is to maintain retail prices in the range of ~$15 to $20 per CD, instead of a price level of approximately $5 per CD, the price they would be with a mechanical licence containing the usual terms, conditions, and royalty rates. In the absence of cost differences, the difference in price between the but for world with the issuance of mechanical licences (~$5 per CD) and the price given the refusal to issue mechanical licences (~$15 per CD) is indicative of the market power maintained by the refusal and the harm to competition.

6. The retail price difference indicates differences of similar magnitudes with respect to wholesale pricing. It should be expected that the wholesale price of the titles would be substantially less than the wholesale prices of similar CDs offered by the labels with publishing rights.

7. The price differential maintained by the refusal far exceeds the normal thresholds for the small but significant and non-transitory price increase used in the hypothetical monopolist test to define relevant markets.

8. The mere exercise of copyright to exclude others is not conduct that typically can be found to violate the *Competition Act.*[2] If an exclusion simply maintains market power in the supply of the copyrighted material, it is considered an acceptable cost during the lifetime of the copyright in exchange for the increased incentives

[2] The exception to this is Section 32 of the *Act.* Section 32 is a special remedy under which the Federal Court can make an order when the conduct involves nothing more than the mere exercise of intellectual property rights.

provided for to the creators of intellectual property. However, if the conduct by the copyright holder creates, enhances, or maintains its market power beyond the level of market power consistent with the mere exclusion of others from using its intellectual property, that conduct engages the *Competition Act.*[3]

9. To manufacture and sell a CD in Canada, a record label wishing to use a pre-existing sound recording must have rights (i) to the sound recording (typically by way of "master sound recording licence") and (ii) to reproduce the song (by way of "mechanical licence"), if those rights have not expired. For certain recordings, namely recordings made in 1964 and earlier, the sound recording rights in Canada are now in the public domain, i.e., the copyright in the sound recording has expired, such that anyone can copy the recording without obtaining a master sound recording licence.

10. For sound recordings not in the public domain, the sound recording and mechanical rights are complementary. Royalties for each will be required to produce a CD. If the wholesale revenue of a CD containing songs for which both the sound recording and the mechanical rights are not in the public domain is *r,* then $r = p + m + \pi + c$ where *p* is the royalty for the performances, *m* the royalty

[3] This is the fundamental distinction that underlies the interface between competition policy and intellectual property rights in Canada. See Section 4.2 Competition Bureau, (2000), *Intellectual Property Enforcement Guidelines.*

for the mechanical right, *c* all other costs of production, and π record label profits.[4]

11. Consider the case of a record label that owns both the publishing and the mechanical rights. The opportunity cost to it of licensing would be its lost profit if the CD was supplied by a rival instead of by the rights holder. If the rival record label is just as efficient as the rights holder then the joint royalty rate would be $r - c = p + m$ and the economic profits of the rights holder would be $\pi = r - c - p - m = 0$: any excess return it earns is attributable to its control of the publishing and mechanical rights.

12. If the mechanical royalty rate administered by the CMRRA is denoted m_R then $p = r - c - m_R$ is the implicit return to the holder of the performing rights if both sets of rights are not in the public domain.

13. Suppose that the sound recording rights expire. If mechanical licences were available at the administered rate m_R then the cost of production would fall to $c + m_R$. This would be the price under competition, and in the absence of other barriers to entry competition should be expected if mechanical licences are available at royalty rate m_R. The vertically integrated record label's upstream publishing division or affiliate would receive mechanical royalties equal to m_R and

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[4] These are economic profits, the excess of revenues over the opportunity cost of all inputs, including the cost of capital (normal profits). In the long run, competition will typically mean that economic profits are zero. If the label has market power in the supply of the CD, then its economic profits are monopoly profits.

its economic profits from the sale of CDs would be zero. The net profits of the integrated record label would be m_R, the royalty rate on its valid song copyrights. The net loss of the vertically integrate firm from the expiry of its performing rights is p. The price of CDs would also fall by this amount, benefiting consumers.

14. However, the vertically integrated firm can continue to capture *p* by following one of two strategies. It can either (i) refuse to supply other labels with a mechanical licence or (ii) it can raise its royalty rate for a mechanical licence. If it refuses to issue mechanical licences, it remains the only supplier of the CD and hence captures $r - c = p + m_R$ because it forestalls the price falling as a result of entry by competitors with lower costs. It could also, in the absence of a regulatory constraint on its mechanical royalty, raise the mechanical royalty rate for rival labels to $m_M = r - c$. Under either strategy its return is maintained at *r-c.*

15. The refusal to issue a mechanical licence to competing firms enables an integrated record label to exercise market power in CDs, maintaining their price at *r* (above the competitive price $c + m_R$) and earning monopoly profits of *p.*

16. The integrated label will be indifferent to adopting either strategy (assuming rivals are equally as efficient). The refusal to issue a mechanical licence is the only strategy that is feasible, however, if there is an external constraint on the mechanical royalty rate, limiting it to m_R. Refusal to license then allows the integrated firm to escape the constraint on its ability to raise mechanical royalty rates.

17. The relevant institutional framework here effectively establishes a compulsory licence regime for mechanical licences with a standard negotiated rate irrespective of whether a sound recording is in the public domain. Subject to a few exceptions regarding budget CDs, the negotiated rate is the same for all songs of a given length, e.g., $0.083 for recordings with a running time of five minutes or less (on a song basis rather than a CD basis this is m_R). Hence the refusal to license and vertical integration or affiliation allows the publishers to escape the constraint on market power implicit in the relevant institutional framework for mechanical rights.

18. The conduct and its effect appears to be more than unilateral. The conduct goes beyond a simple unilateral refusal to deal by individual publishers, but involves a coordinated boycott of Stargrove by *all* Respondent music publishers that utilize CMRRA. CMRRA appears to be the instrument used by music publishers to implement a coordinated boycott of Stargrove. At least two Respondents appear to have directly coordinated efforts to refuse mechanical licences for The Rolling Stones titles in question (Universal and ABKCO) with the intent of putting Stargrove out of business, eliminating it as a potential competitor.

19. Given a fixed royalty rate, more licensing leads to greater sales of CDs that contain the song and hence higher revenues for an unaffiliated music publisher. Hence unaffiliated/non-integrated music publishers have an incentive to maximize volume if they are represented by CMRRA. The decision to not issue an MLA to Stargrove by CMRRA is not in an unaffiliated/non-integrated publisher's unilateral commercial interest. Unaffiliated/non-integrated music

publishers would prefer that Stargrove enter and compete with CDs that contain their songs.

20. The willingness of unaffiliated/non-integrated publishers to participate in the denial of mechanical licences to Stargrove is consistent with a concerted effort on behalf of all music publishers, through CMRRA, to boycott Stargrove. To the extent that the concerted boycott puts Stargrove out of business, it may maintain market power of the integrated labels – who have commercial relationships with the unaffiliated/non-integrated publishers and who have dealings with them as fellow board members of CMRRA – potentially favourably altering the terms of trade in other transactions/dealings.

21. Finally, as part of the “campaign” to prevent Stargrove from entering and supplying CDs to Canadian retailers, there is evidence of at least one integrated record label attempting to dissuade Stargrove’s distributor from handling Stargrove’s CDs. Foreclosing distribution can have a negative effect on competition if it leads to the exit or marginalization of a competitor. Walmart’s potential importance as a retailer of CDs in Canada and Anderson’s status as the exclusive distributor of CDs to Walmart, as well as being a distributor of CDs to other important retailers, e.g., Best Buy, suggest that inducing Anderson not to distribute Stargrove CDs might well result in foreclosure with negative consequences for consumers and competition. It would have this effect if replacing Anderson raised Stargrove’s costs of distribution sufficiently that it was not as effective in constraining the pricing of the integrated labels.

File No. CT-2015-

COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act,* R.S.C. 1985, c. C-34 (the "**Act**");

AND IN THE MATTER OF an application by Stargrove Entertainment Inc. for an order pursuant to section 103.1 of the Act granting leave to bring an application under sections 75, 76, and 77 of the Act;

AND IN THE MATTER OF an application by Stargrove Entertainment Inc. for an order pursuant to sections 75, 76, and 77 of the Act;

AND IN THE MATTER OF an application by Stargrove Entertainment Inc. for an order pursuant to section 104 of the Act;

BETWEEN:

STARGROVE ENTERTAINMENT INC.

Applicant

- and -

UNIVERSAL MUSIC PUBLISHING GROUP CANADA,
UNIVERSAL MUSIC CANADA INC.,
SONY/ATV MUSIC PUBLISHING CANADA CO.,
SONY MUSIC ENTERTAINMENT CANADA INC.,
ABKCO MUSIC & RECORDS, INC.,
CASABLANCA MEDIA PUBLISHING, and
CANADIAN MUSICAL REPRODUCTION RIGHTS AGENCY LTD.

Respondents

PROPOSED NOTICE OF APPLICATION
(under ss. 75, 76, and 77 of the *Competition Act*)

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