UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

In the Matter of POLYGRAM HOLDING, INC., a corporation, DECCA MUSIC GROUP LIMITED, a corporation, UMG RECORDINGS, INC., a corporation, and UNIVERSAL MUSIC & VIDEO DISTRIBUTION CORP., a corporation.	Docket No. 9298

INITIAL DECISION
[Public Record Version]

By: James P. Timony, Administrative Law Judge

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TABLE OF CONTENTS

FINDINGS OF FACT 1

I. BACKGROUND 1

A. History 1
B. Three Tenors 1
C. Respondents 1
D. Warner 3
E. Interstate Commerce 3

II. OLDER THREE TENORS RECORDINGS 4

A. The 1990 Three Tenors Concert 4
B. The 1994 Three Tenors Concert 4

III. THE MORATORIUM AGREEMENT 5

A. Agreement to Restrict Discounting and Advertising 5
B. General Terms 6

IV. NEGOTIATION OF THE MORATORIUM 7

A. PolyGram and Warner Agree to Collaborate 7
B. PolyGram and Warner Negotiate 8

1. Specific terms of the collaboration 8
2. Limited covenant not to compete 9
3. Repertoire 10

C. PolyGram and Warner Consider Ways to Distinguish 3T3 11

1. PolyGram and Warner seek to develop a unique identity for 3T3 11
2. Rudas promises an all-new repertoire 12

V. MORATORIUM AGREEMENT 13

A. Not to Promote Catalogue Products 13

1. Marketing of older albums 13
2. Restrict the marketing of 3T1 and 3T2 14
3. The moratorium applied in the United States 15

B. Marketing Plans for 3T1 15
C. Warner Music International's Discount Campaign for 3T2 17
D. Repertoire for the Paris Concert 20

VI. POLYGRAM AND WARNER REAFFIRM THE MORATORIUM AGREEMENT 21

A. Oral Assurances 21
B. Further Assurances 21
C. Follow-Up Letter 22

1. WMI 23
2. Atlantic relays WMI's assent to PolyGram 23
3. PolyGram enforces the moratorium 23

D. Intervention of PolyGram and Warner Attorneys 24
E. Unfavorable Reviews 26
F. Marketing Campaign for 3T3 in the United States 26
G. PolyGram and Warner Comply with the Moratorium Agreement in the United States 27
H. PolyGram and Warner Comply with the Moratorium Agreement Abroad 28
I. Discounting on 3T2 After the Moratorium Expired 28

VII. EACH OF THE RESPONDENTS AND THE MORATORIUM 28

VIII. OTHER NEW THREE TENORS ALBUMS RELEASED WITHOUT RESTRAINTS 30

A. Sony's Three Tenors Recording Without a Moratorium 30
B. In 1994, Warner Released 3T2 Without A Moratorium 30
C. PolyGram and Warner Compete Directly and Aggressively During the Three Tenors World Tour 33

IX. COMPETITIVE EFFECTS OF THE MORATORIUM AGREEMENT 34

X. EFFICIENCY JUSTIFICATION 37

A. Purpose of the Collaboration 37

B. Free-Riding 39

1. Diversion of sales 39
2. Free-riding defense 41
3. Sharing of advertising expenses 42
4. Free-riding in the United States 42
5. Making 3T3 more distinct from 3T1 and 3T2 43

C. Consumer Confusion 43

1. Respondents' evidence of consumer confusion 44

D. Commercially Sound Marketing Strategy 44

XI. RISK OF RECURRENCE 45

LEGAL ANALYSIS 46

I. SUMMARY OF FACTS 46

A. Joint Venture 46
B. Collaboration on 3T3 47
C. Moratorium Agreement 48
D. Repertoire for the 1998 Concert 49
E. Reaffirmance 49
F. Intervention of Attorneys 49
G. Compliance 50

II. LEGAL DISCUSSION 50

A. Joint Venture 50
B. Ancillary Restraint Doctrine 51
C. Burden of Proof 53

1. *Per Se* Rule 54
2. Rule of Reason 54

D. Competitive Effects 55

1. Must be plausible and valid 58
2. The moratorium must be necessary 60

3. Free-riding 61
4. Consumer confusion 64
5. The moratorium as product promotion 65

CONCLUSIONS OF LAW 67

CEASE AND DESIST ORDER 71

ORDER 72

FINDINGS OF FACT

I. BACKGROUND

A. History

1. The Federal Trade Commission ("FTC") issued a complaint on July 31, 2001, alleging that Respondents PolyGram Holding, Inc. ("PolyGram Holding"), Decca Music Group Limited ("Decca MGL"), UMG Recordings, Inc. ("UMG"), and Universal Music & Video Distribution Corp. ("UMVD") agreed with competitor Warner Communications Inc. ("Warner Communications"): (a) to restrict price competition, and (b) to forgo advertising, violating Section 5 of the Federal Trade Commission Act.

2. On September 17, 2001, the Commission accepted a consent agreement with Warner Communications enjoining agreements with a competitor to fix prices or limit truthful, non-deceptive advertising or promotion. (*Warner Communications Inc.*, C-4025 (Sept. 17, 2001)).

3. A trial of this matter commenced on March 5, 2002. Complaint Counsel called four witnesses. Anthony O'Brien, from Atlantic Recording Corp. (an affiliate of Warner Communications); Rand Hoffman, from PolyGram Holding; Professor Catherine Moore, the director of the Music Business Program at New York University; and Dr. Stephen Stockum, an economist. Respondents rested without calling any witnesses. Both sides introduced numerous documents and deposition testimony of 20 witnesses.

B. Three Tenors

4. The Three Tenors are opera singers Jose Carreras, Placido Domingo, and Luciano Pavarotti. Stip. ¶ 2. Since 1990, they sang every four years at the site of the World Cup soccer finals[1] for a live concert and recording session. Stip. ¶ 84.

5. The Three Tenors recorded three albums of arias and songs. The first album, *The Three Tenors* ("3T1"), was released in 1990 by PolyGram. The second album, *Three Tenors in Concert 1994* ("3T2"), was released in 1994 by Warner. The third album, *The Three Tenors – Paris 1998* ("3T3"), was released in 1998 by PolyGram and Warner. Stip. ¶ 85.

C. Respondents

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[1] The World Cup is an international soccer tournament. The World Cup final match was located in Rome in 1990, in Los Angeles in 1994, and in Paris in 1998. Stip. ¶ 83.

6. Each of the four Respondents is a subsidiary of Vivendi Universal S.A., a French corporation. Stip. ¶ 5. Respondents UMG and UMVD are subsidiaries of Respondent PolyGram Holding. Stip. ¶ 14.

7. Respondent PolyGram Holding is a Delaware corporation with its office and principal place of business located in New York, NY. Stip. ¶ 6.

8. Respondent Decca MGL is a United Kingdom corporation with its office and principal place of business located in London, England. Decca MGL was formerly named, The Decca Record Company Limited ("Decca"). Stip. ¶ 7.

9. Respondent UMG is a Delaware corporation with its office and principal place of business located in Santa Monica, CA. UMG was formerly named, PolyGram Records, Inc. ("PolyGram Records"). Stip. ¶ 8.

10. Respondent UMVD is a Delaware corporation with its office and principal place of business located in Universal City, CA. UMVD is successor to PolyGram Group Distribution, Inc. ("PGD"). Stip. ¶ 9.

11. PolyGram is a group of firms – affiliated with PolyGram N.V. – engaged in the producing, marketing, and distributing recorded music and videos in the United States and worldwide. Comprising Polygram in 1998 were PolyGram Holding, PolyGram Records, PGD, and Decca, all subsidiaries of PolyGram N.V. Stip. ¶¶ 13, 15.

12. In 1998, Decca owned 3T1 and marketed the album. Stip. ¶ 95; F. 102-07. PolyGram Classics & Jazz ("PolyGram Classics"), a division of PolyGram Records, also had marketing responsibilities for 3T1. Stip. ¶¶ 79, 132. PGD distributed 3T1 in the United States. Stip. ¶ 134. PolyGram Holding negotiated the collaboration between PolyGram and Warner with regard to 3T3. Hoffman, Tr. 406-07, 479; F. 65.

13. During 1998, PolyGram Holding provided services to its subsidiaries, including legal, financial, business affairs, and human resources services. Stip. ¶ 16; Hoffman, Tr. 287.

14. Decca was a music "label." Decca develops, acquires, and produces recorded music. Stip. ¶ 74. From 1990 to 1998, Decca owned the copyright to the master recording of 3T1. Stip. ¶ 95. Decca did business in the United States under the name London Records. Stip. ¶ 96.

15. In 1998, PolyGram Classics was a division of PolyGram Records. Stip. ¶ 17. PolyGram Classics was a "label group," assisting PolyGram labels, including Decca, Philips Classics, Deutsche Grammophon, and Verve. PolyGram Classics engaged in marketing, promoting, pricing and advertising 3T1 in the United States. Stip. ¶¶ 79, 132.

16. In 1998, PGD distributed and sold audio and video products in the United States. Stip. ¶ 82. PGD serviced all of the PolyGram labels and joint ventures. Caparro Dep. (CX 609) at 12. During the 1990s, PGD executed PolyGram Classics' marketing strategy as it related to retailers. Caparro Dep. (CX609) at 25-26.

17. Since 1990, compact disc, audio cassette, and video cassette versions of 3T1 were distributed in the United States by PGD, and by its successor UMVD. Stip. ¶ 91. PGD decided the wholesale price and the advertising strategy for audio and video versions of 3T1 sold in the United States. Stip. ¶ 133.

18. In December 1998, PolyGram N.V. was acquired by The Seagram Company Ltd. ("Seagram"). The music businesses of PolyGram N.V. (*i.e.,* Polygram) combined with the music businesses of Seagram to form Universal Music Group ("Universal"). Two years later, Seagram merged with Vivendi S.A. and Canal Plus S.A., to form Vivendi Universal S.A. Stip. ¶ 18.

19. Most of the PolyGram employees in this case were with Universal after the merger, including: Chris Roberts, former President of PolyGram Classics; Rand Hoffman, the former Senior Vice President of Business Affairs for PolyGram Holding; Bert Cloeckaert, the former Vice President for PolyGram in Continental Europe; and Kevin Gore, the former Senior Vice President and General Manager of PolyGram Classics. Stip. ¶¶ 24, 26, 29, 32; Roberts Dep. Vol. 1 (JX 92) at 5-6, 8; Hoffman Dep. (JX 99) 6-7; Cloeckaert Dep. Vol. 1 (JX 97) at 5-7; Gore Dep. (JX 87) at 6-7.

D. Warner

20. Warner Communications, a subsidiary of AOL Time Warner Inc., is a Delaware corporation with its office and principal place of business located in New York, NY. Stip. ¶ 19. Warner Music Group ("Warner") refers to a group of firms – affiliated with Warner Communications – engaged in the business of producing, marketing, and distributing recorded music and videos in the United States and worldwide. Among the firms comprising Warner are Atlantic Recording Corp. ("Atlantic") and Warner Music International ("WMI"). Stip. ¶ 20.

21. Atlantic is a label engaged in the business of developing, acquiring, and producing recorded music. Atlantic operates primarily in the United States. Stip. ¶ 75.

22. WMI manages and coordinates the music operations of Warner operating companies located outside of the United States. Stip. ¶ 21.

E. Interstate Commerce

23. PolyGram and Warner are each vertically integrated producers and distributors of recorded music. Answer ¶¶ 6-7. PolyGram and Warner distribute their products through operating companies ("opcos") – responsible for sales in a particular country. Stip. ¶ 148. In 1998, PolyGram

Classics was the "opco" for the United States for classical music produced by PolyGram. Greene Dep. at 40.

24. Respondent PolyGram Holding, PolyGram Records (the predecessor to Respondent UMG) and PGD (the predecessor to Respondent UMVD) all engage in, or engaged in, acts and practices that affect commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44. Stip. ¶¶ 10-12.

25. In 1998, recorded music products produced by Decca, including 3T1, were distributed throughout the United States, primarily by PGD. Stip. ¶¶ 76, 134; Caparro Dep. (CX 609) at 24-25. In 1998, PGD distributed recorded music and videos, including 3T1, to retailers in each of the fifty states and in the District of Columbia, and maintained a warehouse facility in Indiana from which it distributed recorded music and videos. Stip. ¶ 135; Caparro Dep. (CX 609) at 15, 24-25. Today, recorded music products produced by Decca MGL (including 3T1) are distributed throughout the United States, primarily by UMVD. Stip. ¶ 77.

26. Warner distributed 3T2 and 3T3 in the United States since 1994. O'Brien, Tr. 402-03; O'Brien Dep. (JX 100) at 19. PolyGram and Warner negotiated the Three Tenors moratorium agreement in the United States, including in a meeting in New York, NY in March 1998. F. 90; CX 382.

II. OLDER THREE TENORS RECORDINGS

A. The 1990 Three Tenors Concert

27. The Three Tenors first performed together at the Baths of Caracella in Rome, on the eve of the 1990 World Cup final match in July 1990. Stip. ¶ 86.

28. PolyGram acquired from the concert promoter distribution rights to recordings from the 1990 Three Tenors performance in Rome. CX 213; CX 215; Stip. ¶ 89. Compact disc, audio cassette, and video cassette versions of 3T1 were released by PolyGram in August 1990. Stip. ¶ 90.

29. 3T1 became the best-selling classical album of all time. Stip. ¶ 100. More than twelve million audio units, and three million video units of 3T1 have been sold worldwide. Stip. ¶¶ 101-102. 3T1 was the number one classical album in the United States for 1991 and 1992, and was the third highest selling classical album for 1993. CX 584; CX 585; CX 586.

B. The 1994 Three Tenors Concert

30. On July 16, 1994, the Three Tenors performed at Dodger Stadium in Los Angeles, on the eve of the final match of the World Cup. Stip. ¶ 103. The 1994 Three Tenors concert was organized by concert promoter Tibor Rudas. CX 246 at 3TEN0007695. All of the major music companies,

including PolyGram and Warner, vied to acquire distribution rights for products to be derived from the 1994 Three Tenors concert. CX 247 at 3TEN00011271.

31. During 1993, PolyGram negotiated with Rudas to acquire the right to distribute audio and video recordings of the 1994 Three Tenors concert. Stip. ¶ 104. PolyGram and Rudas were unable to agree upon the final terms of a contract. Kronfeld Dep. (JX 86) at 21-23; CX 228; CX 230; CX 231; Constant Dep. (JX 96) at 80-81.

32. Warner acquired from Rudas the right to distribute audio and video recordings of the 1994 Three Tenors concert. Stip. ¶ 105.

33. At the time of the 1994 concert, Pavarotti was obligated by contract to record exclusively for Decca. Stip. ¶ 108. In 1994, Decca agreed, in exchange for certain considerations, to waive its rights to the exclusive services of Pavarotti as a recording artist, thereby permitting Pavarotti to perform on an audio and video product distributed by Warner. Stip. ¶ 109.

34. Upon the release of 3T2 in 1994 and until 1998, PolyGram (3T1) and Warner (3T2) competed to sell their Three Tenors albums. F. 200-34.

35. Warner considered 3T2 to be a business success. F. 222; O'Brien, Tr. 406.

III. THE MORATORIUM AGREEMENT

36. In 1997, Warner and PolyGram agreed to collaborate on the distribution of products derived from the 1998 Three Tenors concert. Warner would distribute 3T3 in the United States, and PolyGram would distribute 3T3 outside of the United States. F. 59.

37. PolyGram and Warner were concerned that 3T3 would lose sales to 3T1 and 3T2. F. 234-35, 239, 268-73.

38. PolyGram and Warner agreed to a "moratorium" on the discounting and advertising of their older Three Tenors products in the weeks surrounding the release of 3T3. They agreed at a meeting in March 1998, in oral and written communications between PolyGram and Warner representatives in late June/early July 1998. F. 137-53. The agreement was approved by senior executives at PolyGram and Warner. F. 83, 95, 123, 152.

A. Agreement to Restrict Discounting and Advertising

39. PolyGram and Warner executives admit that there was an agreement to restrict discounting and advertising. F. 40-42.

40. In 1998, Anthony O'Brien was Executive Vice President and Chief Financial Officer of Atlantic Records, and Warner's principal contact with PolyGram for the 3T3 project. Stip. ¶¶ 49, 50. O'Brien testified at trial that PolyGram and Warner agreed to restrict the discounting and advertising of 3T1 and 3T2 during 1998 in the United States and worldwide. O'Brien, Tr. 390.

41. Rand Hoffman, Senior Vice President for Business Affairs for PolyGram Holding during 1998, also acknowledged the existence of the moratorium agreement. Hoffman, Tr. 280.

42. Paul Saintilan, the Senior Marketing Director for Decca/PolyGram, acknowledged that PolyGram and Warner agreed to restrict the marketing of 3T1 and 3T2. Saintilan Dep. (JX 94) at 47-48.

43. Contemporaneous internal Warner and PolyGram business documents acknowledge that PolyGram and Warner agreed to limit the discounting and advertising of 3T1 and 3T2 for a period of time around the release of 3T3. JX 1; JX 2; JX 3; JX 4; JX 5 at UMG001527; JX 6; JX 9; JX 28 at UMG001487; JX 40; JX 42; JX 43 at UMG00479-80; JX 48; JX 62 at 3TEN00003536-38; JX 63; JX 64; JX 66; JX 72; JX 74; CX 204;CX 404; CX 429.

B. General Terms

44. PolyGram and Warner agreed to forgo discounts and promotions for the older Three Tenors products for the period from August 1, 1998 through October 15, 1998 (the "moratorium period"). O'Brien, Tr. 390, 443-44; Hoffman, Tr. 311-12; JX 4 at UMG000208; CX 202; JX 9-A.

45. PolyGram and Warner agreed not to "aggressively" discount 3T1 or 3T2 during the moratorium period. Neither party would offer the older ("catalogue") Three Tenors products at a price that would provide an incentive to retailers to sell the product at a price below suggested retail price, or prominently to position the product in the store. O'Brien, Tr. 442-43; Hoffman, Tr. 311-12; JX 3; JX 9-A.

46. PolyGram and Warner agreed not to advertise or promote 3T1 or 3T2 during the moratorium. O'Brien, Tr. 390, 436; JX 1-A; JX 4 at UMG000208.

47. PolyGram and Warner agreed that the moratorium would apply to audio and video products. O'Brien, Tr. 446; Hoffman, Tr. 326; JX 4 at UMG000208; JX 9-A; CX 202; CX 203 at UMG004911.

48. PolyGram and Warner agreed that the moratorium would apply to the marketing of 3T1 and 3T2. O'Brien, Tr. 390; Hoffman, Tr. 312; JX 9-A.

49. PolyGram and Warner understood that, outside of the United States, there might be some discounting of catalogue Three Tenors products during the moratorium period. JX 74 at UMG000203.

50. PolyGram asked Anthony O'Brien that Atlantic not "overstock" retailers with 3T2 in the period prior to August 1, 1998. PolyGram did not want product sold by Atlantic prior to August 1 to be offered by retailers at a discount price after August 1, 1998. O'Brien instructed Atlantic's sales department not to overstock retailers in the United States in the period leading up to August 1, 1998. O'Brien, Tr. 444-45.

IV. NEGOTIATION OF THE MORATORIUM

A. PolyGram and Warner Agree to Collaborate

51. During 1996, concert promoter Tibor Rudas approached Warner to discuss the next Three Tenors project: a huge open-air concert in front of the Eiffel Tower scheduled to coincide with the World Cup finals in Paris in July 1998. CX 319 at UMG004205; O'Brien, Tr. 407.

52. Initially, Warner considered distributing the 3T3 products without a collaboration with PolyGram. O'Brien, Tr. 550-51; CX 317; CX 321 at 3TEN00004277; **CX 322** (*in camera*).

53. During the negotiation with Rudas, Warner was concerned that Rudas might make a deal for 3T3 with another music company. CX 354 at 3TEN00002271; **CX 355 at 3TEN00003298** (*in camera*).

54. During 1996, Rudas also discussed with PolyGram the possibility of PolyGram acquiring the rights to the 1998 Three Tenors concert. Stip. ¶ 122; CX 315. In November 1996, Decca/PolyGram executives negotiated with Rudas and requested PolyGram's senior executives' approval to make an offer for the rights to the 3T3 project; PolyGram did not anticipate collaboration with Warner. CX 327.

55. In 1998, as in 1994, Pavarotti was under exclusive contract to record for PolyGram. Stip. ¶ 125. In the spring of 1997, Ahmet Ertegun, the Chairman of Atlantic (a Warner subsidiary based in the United States) met with Alain Levy, his counterpart at PolyGram, "to ask that PolyGram allow Luciano Pavarotti to record the project for [Warner]." CX 366 at 3TEN00007334.

56. At the meeting, PolyGram's counter-offer was that Warner and PolyGram should "be partners for the 1998 concert project and all derivative product[s]." CX 366 at 3TEN00007334. *See also* JX 22 at UMG001342; CX 345 at UMG001635.

57. Warner calculated that, on the conservative assumption that the third Three Tenors album sold only 60 percent as well as 3T2, then Warner and PolyGram would each make over $5.5 million. CX 366 at 3TEN00007334. If the profits had been projected to be only $3 million, Warner still would have gone ahead with the deal. O'Brien, Tr. 412.

B. PolyGram and Warner Negotiate

58. By a series of contracts dated October 14, 1997, in return for an $18 million advance and other consideration, Rudas licensed to Warner the worldwide audio, video, and home television rights to the 1998 Three Tenors concert and a box set and greatest hit albums from 3T1, 3T2 and 3T3 (the "3T3 Rights"). Stip. ¶ 126; **JX 11** (*in camera*); **CX 205** (*in camera*); **CX 206** (*in camera*).

1. Specific terms of the collaboration

59. Pursuant to the Concert/License Agreement dated December 19, 1997, Warner and PolyGram agreed to collaborate on the distribution of products derived from the 1998 Three Tenors World Cup concert. The contract is formally between Warner Benelux B.V. and PolyGram S.A. Stip. ¶ 127; JX 10.

60. The contract between PolyGram and Warner provides that:

a. Atlantic, a Warner affiliate, is responsible for exploiting the 3T3 Rights within the United States. JX 10-N.[2]

b. Warner licenses to PolyGram the right to exploit the 3T3 Rights outside of the United States. JX 10-N-O.

c. Warner and PolyGram are separately responsible for developing and implementing marketing plans for their respective territories. Neither party has the right to approve or disapprove the other's marketing plans. JX 10-P, T. However, Warner and PolyGram agree to "consult and coordinate" with respect to marketing and promotion activities in connection with the exploitation of the 3T3 Rights. JX 10-P.

d. Warner and PolyGram are each entitled to 50 percent of the net profits and net losses derived from the worldwide exploitation of the 3T3 Rights (as well as from the production of a Greatest Hits album and/or a Box Set incorporating the 1990, 1994, and 1998 Three Tenors albums). JX 10-Q.

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[2] To "exploit" a recording is a music industry term that encompasses selling, advertising, marketing, and promoting the album. O'Brien 422:6-11.

e. PolyGram agrees to reimburse Warner for 50 percent of the $18 million advance paid to Rudas. JX 10-S.

f. Other expenses incurred by either Warner or PolyGram in the exploitation of the 3T3 Rights are to be deducted from revenues for purposes of calculating net profits (losses). JX 10-Q-S.

2. Limited covenant not to compete

61. In negotiating the terms of the 1998 Three Tenors project, PolyGram and Warner discussed the scope of a covenant not to compete. Several iterations of this contract provision were exchanged over a one month period. **CX 357** (*in camera*); **CX 359** (*in camera*); **CX 361** (*in camera*).

62. PolyGram and Warner decided that for four years following the release of 3T3, neither PolyGram nor Warner would release a new Three Tenors album. However, the contract provides that PolyGram shall be free to exploit 3T1, and that Warner shall be free to exploit 3T2.

a. The original draft of the Concert/License Agreement, prepared by PolyGram and forwarded to Warner on November 19, 1997, contained no covenant not to compete. **CX 357** (*in camera*); **Hoffman, Tr. 374** (*in camera*).

b. On December 8, 1997, Warner requested that the draft Concert/License Agreement be modified to include a provision restricting both PolyGram and Warner from releasing a new Three Tenors album. **CX 358** at 3TEN00002443 (*in camera*). Warner was concerned that a new Three Tenors album would capture sales from 3T3 and diminish the profitability of the venture. O'Brien, Tr. 420.

c. PolyGram was also concerned that a new Three Tenors album may interfere with sales of 3T3 and diminish its profitability. Hoffman, Tr. 305. PolyGram forwarded to Warner a second draft of the Concert/License Agreement. The second draft, dated December 15, 1997, includes a provision captioned "Holdback on Future Three Tenors Products." The Holdback Provision provides that neither PolyGram nor Warner shall release a Three Tenors album until June 2002. **CX 359 at 3TEN00002410** (*in camera*).

d. On December 14, 1997, Warner communicated to PolyGram its request that the Holdback Provision be amended: **[redacted] [redacted] CX 359 at 3TEN00002410** (*in camera*).

e. On December 15, 1997, PolyGram forwarded to Warner a revised version of the Contract/License Agreement. PolyGram amended the Holdback Provision so as to

exclude any restriction on the exploitation of 3T1 and 3T2. **CX361 at 3TEN00002400** (*in camera*); O'Brien, Tr. 421.

f. On December 18, 1997, Warner requested an additional modification to the Holdback Provision. **[redacted] [redacted] [redacted]** Thus, the draft contract was amended to prohibit – for a four year period – the re-packaging of either 3T1 (by PolyGram) or 3T2 (by Warner). **CX 362 at 3TEN00002316** (*in camera*).

63. The parties' non-compete obligation is contained in Paragraph 9 of the final, executed Concert/License Agreement:

> <u>Holdback on Future "Three Tenors" Products</u>: Neither Warner nor PolyGram (nor any of their respective parents or affiliates) shall release any phonograph record or audiovisual device embodying the joint performances of all of the Artists (whether pre-existing or newly recorded), anywhere in the world, until June 1, 2002, unless such release is pursuant to this agreement. Nothing contained in this paragraph 9 shall be construed to prohibit (a) Warner from continuing to exploit the 1994 Album or (b) PolyGram from continuing to exploit the 1990 Album (as defined in the Rights Agreements).

JX 10-U-V at UMG001076-77.

64. As of the date the Concert/License Agreement was entered into, PolyGram did not know Warner's plans for the exploitation of 3T2 upon the release of 3T3. Hoffman, Tr. 305. As of the date the Concert/License Agreement was entered into, Warner did not know PolyGram's plans for the exploitation of 3T1 upon the release of 3T3. O'Brien, Tr. 501, 548.

65. Although the Concert/License Agreement is formally between Warner Benelux B.V. and PolyGram S.A., the Holdback Provision was understood by both parties to apply to all Warner affiliates and to all PolyGram affiliates. Hoffman, Tr. 305-07; O'Brien, Tr. 421-22.
Rand Hoffman, the PolyGram Holding executive who negotiated the Concert/License Agreement, understood his role in these negotiations as representing all of PolyGram, and not just the French company (PolyGram S.A.) that ultimately executed the agreement. Hoffman, Tr. 307; Stip. ¶ 29.

3. Repertoire

66. Warner, Polygram and Rudas negotiated who would control the repertoire for the 1998 Three Tenors concert and recordings. Warner and PolyGram recognized that the success of the new

Three Tenors album was tied to the repertoire. The music companies wanted to be sure that the repertoire on 3T3 would be "distinctive," and that it would not repeat selections from the earlier Three Tenors recordings. Roberts Dep. (JX 92) at 12-16; Hoffman, Tr. 300; O'Brien, Tr. 410; CX 331; CX 343; CX 402; CX 330 at UMG000512.

67. Warner and PolyGram proposed to Rudas that they should have the right to approve a significant part of the repertoire to be performed and recorded at the 1998 Three Tenors concert. **CX 322 at 3TEN00006987** (*in camera*); CX 337; CX 340 at 3TEN00000523; CX 349 at 3TEN00000520; CX 354 at 3TEN0002272; O'Brien, Tr. 410.

68. Rudas insisted that he and the artists should control the choice of songs. CX 334; O'Brien, Tr. 410.

69. In 1997, Phil Wild was Executive Vice President for Atlantic/Warner. In a memo to senior management, dated November 7, 1997, Wild identified the repertoire issue as one of the most significant business risks presented by the Three Tenors transaction. CX 354 at 3TEN00002272; *see also* CX 356 at 3TEN00002249; O'Brien, Tr. 418.

70. Wild's memo identifies and discusses several other "significant business risks" associated with the 3T3 transaction. Wild does not identify as a problem free-riding, consumer confusion, or difficulties in developing an effective marketing strategy for 3T3. CX 354 at 3TEN00002271-00002273.

71. PolyGram and Warner agreed to forgo the right to approve the repertoire for the 1998 concert. CX 356 at 3TEN00002249; JX 22 at UMG001342; O'Brien, Tr. 418.

72. **[redacted]**
[redacted]
[redacted]
[redacted]
[redacted]
[redacted]

C. PolyGram and Warner Consider Ways to Distinguish 3T3

73. In 1996 and 1997, prior to agreeing to distribute 3T3, both PolyGram and Warner were concerned that the 1998 Three Tenors album would be neither as original nor as commercially appealing as the 1990 and 1994 releases. CX 318 at UMG004146, UMG004150; CX 321 at 3TEN000004277; CX 424 at UMG003563.

1. PolyGram and Warner seek to develop a unique identity for 3T3

74. PolyGram and Warner considered marketing strategies aimed at creating a unique identity for the 1998 album, distinct from the previous Three Tenors recordings. Saintilan Dep. (JX 94) at 101; CX 381 at 3TEN00000247; CX 386 at UMG004596; CX 423 at UMG003603.

75. PolyGram executives wished to differentiate the 1998 concert by including a guest performer. Stip. ¶ 128; Roberts Dep. (JX 92) at 25-27. However, this suggestion was rejected by the Tenors. Roberts Dep. (JX 92) at 25-26; CX 318 at UMG004150.

76. PolyGram considered the writing of original songs from Andrew Lloyd Webber, Elton John, Stevie Wonder, or, from writers associated with Celine Dion, Barbra Streisand, Andrea Bocelli and Whitney Houston. CX 485 at UMG004182. *See also* CX 331 at UMG004183-184. These ideas were not implemented.

77. PolyGram and Warner discussed "positioning" themes for 3T3. Positioning means "creating an identity or a set of messages around a CD that differentiate [it] from other CDs." Saintilan Dep. (JX 94) at 61. For example, emphasizing "that it was a spectacular Parisian event, that it was an awesome spectacle with a completely different context from either the '94 album or the '90 album." Saintilan Dep. (JX 94) at 101-02.

78. The parties also recognized the desirability of designing packaging for the 1998 Three Tenors products that was "as different as possible from the two previous releases." CX 383 at UMG003284; JX 26 at UMG000372; Saintilan Dep. (JX 94) at 66-67.

2. Rudas promises an all-new repertoire

79. On January 6, 1998, Tibor Rudas publicly announced that the Three Tenors would perform in Paris in front of the Eiffel Tower, on July 10, 1998, as part of the World Cup celebrations. Rudas promised "a totally new repertoire of operatic arias and world-renowned popular songs." CX 380 at 3TEN00003979.

80. Rudas assured the music companies that the album to be recorded in Paris would consist of new songs not appearing on the prior two albums. CX 387 at UMG003148.

81. The message that 3T3 would contain all new repertoire was one of the promotional themes presented to the media by PolyGram and Warner. CX 477 at 3TEN00008809; Saintilan Dep. (JX 94) at 112; CX 496; JX 82 at UMG003855.

82. Despite the desire for all new repertoire for 3T3 to increase the likelihood of 3T3's commercial success, PolyGram and Warner concluded that the repertoire was disappointing. F. 133-36.

V. MORATORIUM AGREEMENT

A. Not to Promote Catalogue Products

83. The idea of a moratorium came from Chris Roberts, President of PolyGram Classics. Saintilan Dep. (JX 94) at 41. Roberts was concerned about the activities of PolyGram's own operating companies, and wanted to be sure that they did not promote 3T1 in a way that would divert sales from 3T3. Saintilan Dep. (JX94) at 41, 44-45. Roberts expressed this concern to Paul Saintilan, PolyGram's employee responsible for managing the marketing of 3T3. Saintilan Dep. (JX94) at 41-42.

84. In early 1998, Paul Saintilan relayed to PolyGram operating companies Chris Roberts' view that 3T1 should not be promoted in a way that captures sales from 3T3, during its release. PolyGram operating companies replied that if Warner was promoting 3T2, they wanted to be free to promote 3T1. Saintilan Dep. (JX 94) at 41-42; Saintilan Dep. (JX 94) at 46.

1. Marketing of older albums

85. On January 29, 1998, representatives of PolyGram and Warner first met to discuss "marketing and operational issues" relating to the release of 3T3. Saintilan Dep. (JX 94) at 56-57. The minutes of the January 29 meeting, prepared by Paul Saintilan shortly after the meeting, are in evidence as CX 383. Saintilan Dep. (JX94) 55-56.

86. The following persons attended the January 29, 1998 meeting: From Warner, Pat Creed, Vicky Germaise, and Margo Scott. From PolyGram, Chris Roberts (PolyGram Classics), Rand Hoffman (PolyGram Holding), Roger Lewis (Decca), and Paul Saintilan (Decca). Wayne Baruch, a representative of Rudas also attended. CX 383 at UMG003282; Saintilan Dep. (JX 94) at 56.

87. The marketing of 3T3 was discussed at the January 29, 1998 meeting. Chris Roberts (PolyGram Classics) raised with the group his "general concern" over how older Three Tenors products would be marketed upon the release of 3T3. Saintilan Dep. (JX 94) at 42-43. One option, Roberts indicated, was to "impose an ad moratorium until November 15." CX 383 at UMG00328; Saintilan Dep. (JX 94) at 72-73. There were "no concrete discussions" regarding the proposed advertising moratorium. Roberts raised the issue of advertising older Three Tenors albums, and suggested that it could be resolved at some future date. Saintilan Dep. (JX 94) at 42-43.

88. At the January 29, 1998 meeting, PolyGram and Warner did not reach any agreement. Saintilan Dep. (JX 94) at 73, 109-10.

89. At an internal PolyGram meeting on February 9, 1998, Saintilan noted that there were "No restrictions on 1990/1994 products." CX 386 at UMG004596.

2. Restrict the marketing of 3T1 and 3T2

90. The next meeting of PolyGram and Warner to discuss the 3T3 project was held in New York on March 10, 1998. CX 383 at UMG003289; Saintilan Dep. (JX 94) at 75. Between the January 29 meeting and the March 10 meeting, there had been no communications between PolyGram and Warner relating to the proposed Three Tenors moratorium. Saintilan Dep. (JX 94) at 75. Saintilan's notes from the March 10 meeting, prepared on or about March 10, 1998, are in evidence as JX 5. Saintilan Dep. (JX 94) at 110-11.

91. The following persons attended the March 10, 1998 meeting: From PolyGram, Roger Lewis (Decca), Paul Saintilan (Decca), Rand Hoffman (PolyGram Holding), and Alex Darbyshire (PolyGram Video). From Warner, Vicky Germaise, Pat Creed, and Margo Scott. Wayne Baruch representing Rudas also attended. JX 5 at UMG001523; Hoffman, Tr. 308-09.

92. At the March 10, 1998 meeting, PolyGram and Warner discussed the marketing of 3T1 and 3T2. Saintilan Dep. (JX 94) at 113. Saintilan's notes of the March 10, 1998 meeting state that, at the meeting, the parties agreed "that a big push on catalogue shouldn't take place before November 15." JX 5 at UMG001527; *see also* CX 388 at 3TEN0000800.

93. Catalogue is a music industry term that refers to older albums that continue to be offered for sale by a music company. Hoffman, Tr. 309-10; O'Brien, Tr. 394.

94. The agreement between PolyGram and Warner to forgo a "big push" on catalogue products was explained by Saintilan at his deposition. According to Saintilan, at the March 10, 1998 meeting, PolyGram and Warner agreed to observe a "window" or "moratorium" at the time of the release of 3T3 in which price discounting and promotion of 3T1 and 3T2 would not take place. Saintilan Dep. (JX 94) 115-16.

95. Roger Lewis, President of Decca, attended the March 10, 1998 meeting and discussed the marketing of 3T1 and 3T2. Lewis approved of the moratorium agreement. Saintilan Dep. (JX 94) at 117.

96. Saintilan understood that, at this meeting, a commitment to the moratorium was made by Decca for all PolyGram companies worldwide, including the PolyGram affiliates in the United States. Saintilan understood that a commitment to the moratorium was made by the Warner representatives on behalf of all Warner companies worldwide, including the Warner operating companies in the United States. Saintilan Dep. (JX 94) at 124-25.

97. During the March 10, 1998 meeting, the starting date for the moratorium was not specified. JX 5 at UMG001527.

3. The moratorium applied in the United States

98. The understanding reached by PolyGram and Warner at the March 10, 1998 meeting was that the moratorium on discounts and advertising would include all markets worldwide, including the United States. Saintilan Dep. (JX 94) at 116. PolyGram was concerned about possible discounting of 3T2 by Warner. Saintilan Dep. (JX 94) at 77.

99. In order for PolyGram to implement the moratorium in the United States, PolyGram needed the cooperation of PolyGram Classics and PGD. Saintilan Dep. (JX 94) at 49.

100. In 1998, Kevin Gore was the Senior Vice President and General Manager of PolyGram Classics in the United States. Stip. ¶ 26.

101. In the spring of 1998, Paul Saintilan spoke to Kevin Gore about the Three Tenors moratorium. This conversation took place in the United States. Saintilan told Gore that he (Saintilan) wanted PolyGram Classics to forgo discounting and advertising for 3T1 in the United States for a period of time. Gore responded that PolyGram Classics "would seek to comply." Saintilan Dep. (JX 94) at 49-50. Saintilan understood that Gore intended to communicate with PGD regarding the moratorium, and to ensure that PGD complied with its terms. Saintilan Dep. (JX 94) at 51.

B. Marketing Plans for 3T1

102. By memorandum dated February 27, 1998, Saintilan requested that each PolyGram operating company provide Decca/PolyGram with an outline of its local marketing campaign for 3T1 and 3T3. CX 417 at UMG003382. With regard to 3T1, Saintilan sought a description of planned marketing activities, expenditures, and target incremental sales. CX 417 at UMG003390-003391. The memo requested that the operating companies respond by March 18, 1998. CX 417 at UMG003382, 003390.

103. The opcos responded to Saintilan's request by submitting a description of planned marketing activities for 3T1. JX 50 at UMG003661-62. Several of the PolyGram operating companies planned price discounting and advertising campaigns for 3T1 during 1998. JX 50 at UMG003666, 003685, 003746; CX 427; JX 37.

104. During 1998, the practice within PolyGram was that if an operating company wished to reduce the price of 3T1, that operating company was supposed to request and obtain the consent of both Decca (the repertoire owner) and PolyGram Vice President Bert Cloeckaert. Cloeckaert Dep. (JX 97) at 52; Cloeckaert Dep. (JX 98) at 176-77; CX 510 at UMG006328; CX 543 at UMG006214; Hoffman, Tr. 313.

105. In the spring of 1998, several Polygram operating companies formally requested permission from Decca and PolyGram to discount and promote 3T1. JX 35; CX 401; CX 402; CX 403; CX 404; CX 427. PolyGram operating companies wished to offer 3T1 at a discount price for all or part of the period running from August 1 to October 15, 1998. CX 403; CX 428; CX 429 at UMG003056; CX 442 at UMG000195; JX 35; JX 46.

106. PolyGram's reduction in the price of 3T1 in Europe during the pre-moratorium period did lead to higher sales levels. Cloeckaert Dep. (JX 97) at 81.

107. PolyGram instructed its operating companies: (i) that in view of the upcoming World Cup tournament, they could reduce the price of 3T1 and advertise its availability; but (ii) pursuant to an agreement with Warner, aggressive marketing campaigns in support of 3T1 would have to terminate by the end of July 1998:

a. "To keep in line with an agreement laid down with Atlantic and [PolyGram Classics President] Chris Roberts, we should not encourage any promotion on the original [Three Tenors] album from the day of release of the new album (probably in-store August 10) for a period of around 6 weeks." JX 40.

b. "We have agreed with Warners to discourage any promotion on the first [Three Tenors] album from the day of release of the <u>new</u> album . . . for a period of around 6 weeks. So all promotion on the first album should have stopped by then." CX 404 (emphasis in original).

c. "PolyGram has made an undertaking to Atlantic Records that no advertising or point of sale material originated for the launch of the new album will feature packshots of the 1990 album. This is based on Atlantic reciprocating by omitting the 1994 album in their initial POS [point of sale]/ads, and telling their opcos to back off promoting the 1994 album worldwide until a sufficient window has been observed." JX 28 at UMG001487.

d. "Following further discussions with Warners regarding the joint marketing of the 1998 '3 Tenors' album, it is now felt that we should avoid any aggressive <u>price campaigns</u> of the 1st '3 Tenors' album. This means that we will be unable to give consent to Germany and France for their campaigns and that we shall

discourage any further requests from other opcos . . . . We do hope that you will appreciate that this decision is partly beyond our control and arises from a complex set of ongoing negotiations between PolyGram, Warners and the Rudas Organization." JX 42 (emphasis in original).

e. "After considerable discussion with Atlantic and other parties, the mid-price campaign first canvassed by Bert Cloeckaert in Europe has also been re-introduced (mid-price royalty break available from Stephen Greene on application) . . . . Atlantic and PolyGram have agreed that we will jointly refrain from any promotion of the previous albums that could potentially undermine sales of the new album around the time of the initial release." CX 459 at UMG SK 0005.

C. Warner Music International's Discount Campaign for 3T2

108. In April 1998, Chris Roberts, President of PolyGram Classics, instructed Paul Saintilan to "ensure" that Warner would comply with the moratorium agreement. JX 34.

109. Saintilan requested that Warner provide to PolyGram copies of Warner's internal directives to Warner operating companies instructing compliance with the moratorium agreement. JX 34.

110. During 1998, Pat Creed was Senior Director for Product Development for Atlantic Records, and was responsible for marketing and promotional activities for 3T3 in the United States. Stip. ¶ 36. Creed attended the March 10, 1998 marketing meeting at which the Three Tenors moratorium was first agreed upon by PolyGram and Warner. JX 5 at UMG001523.

111. On April 29, 1998, Saintilan (Decca/PolyGram) sent a letter to Creed (Atlantic/Warner) seeking assurance that Warner was planning to abide by the moratorium. The letter to Warner refers to PolyGram's written instructions to PolyGram operating companies requiring an end to discounting of 3T1 by July 24, 1998. Saintilan requested confirmation that Warner planned to "enforce the same window." JX 6.

112. Pat Creed forwarded Saintilan's April 29, 1998 letter to Anthony O'Brien, Executive Vice President and Chief Financial Officer of Atlantic. Creed's cover memo notes that Saintilan's letter includes "a copy of the message sent by Decca to their affiliates around the world. They are still looking for some sort of assurance from us that the same is being done for Warner Music International." CX 415 at 3TEN00010551.

113. Saintilan also sent a copy of his April 29, 1998 letter to Rand Hoffman (PolyGram Holding). Hoffman forwarded a copy of the letter to Margo Scott, an attorney for Warner. Hoffman, Tr. 320.

114. Warner Music International ("WMI") personnel were not involved in planning for the release of 3T3, and were not aware of discussions concerning the moratorium. No WMI representatives attended any of the joint PolyGram/Warner marketing meetings, and there is no

evidence that WMI was provided with any information regarding the marketing plans for 3T3. F. 86, 91.

115. In December 1997, WMI began planning a television advertising campaign for 3T2 to run in Europe from July through December 1998. WMI planned "to aggressively advertise, position and discount-price the 1994 album" throughout the second half of 1998. CX 443 at 3TEN00003641; CX 366 at 3TEN00007335; O'Brien, Tr. 414.

116. WMI forecast that dropping the wholesale price of the 3T2 from $13.40 per unit to $8.50 per unit, combined with an aggressive advertising campaign, would increase the company's sales of 3T2 by 170 percent. JX 31 at 3TEN00009930. In order to subsidize a price cut, in-store merchandising, and television and press advertising for 3T2, WMI asked Rudas to grant WMI a temporary reduction in royalties owed. JX 60 at 3TEN00003561. WMI assured Rudas that, given the anticipated increase in sales volume for 3T2, Rudas would garner higher profits at the lower royalty rate. JX 60 at 3TEN00003561; JX 31 at 3TEN00009930.

117. In May 1998, Tibor Rudas consented to a reduced royalty rate for the 3T2 audio and video products for the period from May to December 1998. CX 426 at 3TEN00003557-58; JX 60 at 3TEN00003561 ("to 1st Jan agree"); CX 431 at 3TEN00009923; CX 432; CX 434 at 3TEN00011049; CX 435 at 3TEN00017899; CX 436; CX 448 at 3TEN00011077-78.

118. On May 15, 1998, WMI issued a bulletin to its operating companies announcing the launch of a discount campaign for 3T2, effective from May 17, 1998 until December 31, 1998. CX 435 at 3TEN00017900.

119. In June 1998, Polygram obtained a copy of WMI's bulletin announcing the discount campaign for 3T2, scheduled to run through December 1998. CX 425 at UMG000166-67.

120. PolyGram obtained information indicating that Warner would be selling 3T2 at a substantial discount. CX 429 at UMG003056; CX 441.

121. PolyGram's operating companies informed Saintilan and PolyGram's central management that they wanted to respond to Warner's price discounts on 3T2 by discounting PolyGram's 3T1. CX 425 at UMG000167; CX 429 at UMG003056; CX 440; CX 442 at UMG000194.

122. Rand Hoffman served as PolyGram's liaison with Warner for contract issues relating to the 3T3 project. In June 1998, Chris Roberts (PolyGram Classics) forwarded to Hoffman a note complaining that Warner was discounting 3T2 in Europe. JX 66.

123. Hoffman had attended the March 10, 1998 marketing meeting, and understood that PolyGram and Warner representatives had agreed to implement the moratorium. Hoffman, Tr. 280; JX 5 at UMG001523.

124. On June 11, 1998, Hoffman sent a letter to Warner. Hoffman, Tr. 322. Hoffman complained that in Denmark, and perhaps elsewhere in Europe, Warner was offering 3T2 at a "very low price." This action, Hoffman charged, contravened the understanding between PolyGram and Warner. Hoffman asked that Warner take steps to eliminate this discounting (JX 64).

125. Hoffman was not then aware that the moratorium period was scheduled to commence at the end of July. When informed of this fact, Hoffman revoked his letter. JX 66; Hoffman, Tr. 322-23; JX 63.

126. PolyGram understood that its central management did not have complete control over the prices charged by its operating companies, and understood that Warner had similar problems controlling its operating companies. Saintilan Dep. (JX 94) at 153. PolyGram therefore was concerned that it would be difficult for both companies to implement the moratorium consistently on a worldwide basis. Hoffman, Tr. 322; Saintilan Dep. (JX 94) at 153.

127. Chris Roberts, President of PolyGram Classics, advised that the moratorium agreement was likely to fall apart because of the mutual distrust between PolyGram and Warner at the level of the operating companies. Saintilan Dep. (JX 94) at 134-136; JX 66.

128. Saintilan distributed an e-mail message to PolyGram executives that PolyGram should not coax its operating companies to abide by the moratorium: If Warner discounted 3T2 in a local market, the PolyGram operating company would be permitted to "retaliate" with discounts on 3T1. Saintilan Dep. (JX 94) at 138; JX 66.

129. During June 1998, senior management at PolyGram felt that there was likely to be discounting and promotion of the older Three Tenors products upon the release of 3T3. Saintilan Dep. (JX 94) 139, 154. PolyGram did not modify its plans for advertising and promoting 3T3. Saintilan Dep. (JX 94) at 139.

130. PolyGram's response to the expectation that Warner would be discounting 3T2 upon the release of 3T3 was to notify its operating companies that they were free to retaliate by discounting 3T1. JX 9-B at 3TEN0000013; JX 1-B.

131. Anthony O'Brien and other executives at Atlantic/Warner became aware that Warner's international operation, WMI, was using a discount campaign to sell 3T2, and that the Three Tenors moratorium agreement was in jeopardy. JX 68.

132. On June 24, 1998, Atlantic forwarded a memo to Ramon Lopez, the President of WMI. Atlantic warned WMI that its price cut on 3T2 could lead PolyGram to discount its catalogue Three Tenors album. CX 443 at 3TEN00003641. Ramon Lopez, President of WMI, responded to Atlantic on July 1, 1998, insisting that PolyGram had initiated the price reduction. JX 8.

D. Repertoire for the Paris Concert

133. In June 1998, Rudas informed PolyGram and Warner of the intended repertoire for the upcoming Three Tenors concert. CX486-88. PolyGram and Warner were alarmed to learn that the intended repertoire for the 1998 Three Tenors concert was "not substantially new." CX 490; CX 489; O'Brien, Tr. 424-25. It would overlap with the repertoire of the earlier Three Tenors concerts: "4 out of the 5 songs Pavarotti is considering singing were performed in either 1990 or 1994. In addition, 7 of the 8 scheduled encores were performed in either 1990 or 1994." CX 489-90.

134. The parties were concerned that if the overlap in repertoire between 3T3 and the earlier Three Tenors albums was too extensive, then 3T3 could lose sales to 3T1 and 3T2. O'Brien, Tr. 426.

135. On several occasions from mid-June through to the date of the concert, PolyGram and Warner expressed to Tibor Rudas their dissatisfaction with the intended repertoire. CX 487; CX 489-90.

136. PolyGram and Warner understood that the Tenors' failure to deliver a new repertoire at the 1998 concert jeopardized the commercial success of the 1998 album and video. According to Warner executive Anthony O'Brien:

> [T]he problem that we had was that The Three Tenors [are] perhaps three of the laziest performers we have ever seen performing this type of music, and what we were hoping for, when we were making the '98 concert, was to have new and exciting repertoire. . . And they're not particularly given to sort of learning new arias, and so Nessun dorma! would come back again, or maybe Carreras would sing one of the Pavarotti songs or vice versa. And so although the album was different . . . it wasn't, perhaps, quite as new and exciting as we had hoped it to be.

O'Brien I.H. (JX101) at 74:2-16. Warner and PolyGram lost several million dollars on sales of 3T3. O'Brien, Tr. 523-25.

VI. POLYGRAM AND WARNER REAFFIRM THE MORATORIUM AGREEMENT

A. Oral Assurances

137. On June 25, 1998, Anthony O'Brien (Atlantic/Warner) and Paul Saintilan (Decca/PolyGram) discussed by telephone the Three Tenors moratorium. JX 9-A at 3TEN0000012; JX 74.

138. During the June 25, 1998 telephone conversation, Saintilan reaffirmed PolyGram's willingness to forgo discounting and advertising of 3T1, provided that Warner reciprocated with regard to 3T2. O'Brien assured Saintilan that his company, Atlantic, would comply with the moratorium agreement in the United States. O'Brien, Tr. 433.

139. O'Brien also told Saintilan that he would communicate with representatives of WMI to ensure that WMI would also abide by the moratorium. O'Brien, Tr. 433.

140. During the June 25, 1998 telephone conversation, O'Brien understood that Saintilan had the authority to agree, and did agree, to the moratorium on behalf of all of PolyGram. O'Brien, Tr. 434.

B. Further Assurances

141. On July 2, 1998, Paul Saintilan forwarded a letter to Anthony O'Brien confirming the terms of the moratorium, and requesting additional assurances that Warner intended to comply on a worldwide basis. The letter specifies that audio versions of 3T1 and 3T2 will not be discounted or advertised for the period from August 1 to October 15, 1998. JX 9-E.

142. Later the same day, July 2, 1998, Paul Saintilan forwarded a revised letter to Anthony O'Brien confirming the terms of the moratorium, and requesting additional assurances that Warner intended to comply on a worldwide basis. The revised letter makes it clear that the proposed moratorium agreement should apply to both Three Tenors albums and Three Tenors videos. JX 9-A at 3TEN00000012.

143. O'Brien understood the July 2, 1998 letter from Saintilan to be for the purpose of detailing the terms of the moratorium. O'Brien, Tr. 434.

144. The two letters dated July 2, 1998 from Saintilan (Decca/PolyGram) to O'Brien (Atlantic/Warner) were sent to Rand Hoffman (PolyGram Holding) in New York, who forwarded them on to O'Brien (Atlantic/Warner). JX 9-A ("via Rand Hoffman") and JX 9-E ("via Rand Hoffman").

C. Follow-Up Letter

145. The Three Tenors performed in concert in Paris on July 10, 1998. O'Brien, Tr. 435.

146. O'Brien was in Paris on July 10 to attend the Three Tenors concert. O'Brien, Tr. 435.

147. On July 10, 1998, Saintilan (Decca/PolyGram) forwarded a follow-up letter to O'Brien (Atlantic/Warner) providing additional details regarding the implementation of the moratorium agreement, and again seeking formal confirmation of Warner's intention to comply on a worldwide basis:

> **re: THREE TENORS MORATORIUM ON 1990 & 1994 ALBUMS**
>
> As discussed, we fully support a moratorium on the above albums which we strongly believe will be to our mutual benefit. The dates we are prepared to commit to are from August 1 to November 15 (subject to the qualifications in italics below).
>
> The moratorium would constitute the following:
>
> **1. Advertising and promotion**
>
> The original 1990 album would not be advertised or promoted during this period. We have already omitted the 1990 album from all advertising and point of sale materials centrally originated for the new album.
>
> **2. Pricing**
>
> The original 1990 album would be sold at the top classical price point that it has historically traded at in each market . . . .
>
> As discussed before, PolyGram operating companies have already been advised of the above moratorium, however we have informally allowed it to collapse at a local level to allow a response to Warners pricing. When we have a clear undertaking from Warners that the above agreement will be adhered to, we will re-enforce things from our side . . . .

> So in summary, once a price agreement has been made, and we have clear evidence that Warners will enforce the moratorium, then we will re-enforce the moratorium on our side.

JX 1-A-B.

1. WMI

148. The PolyGram letters were distributed to senior executives within Warner, including Ramon Lopez, President of WMI. This led to a series of internal discussions. O'Brien, Tr. 434:-35, 437; CX 202; CX 457. Lopez acceded to the request of the Atlantic executives to comply with the moratorium between August 1, 1998 and October 15, 1998. O'Brien 437-39; JX 3; JX 2.

149. On July 13, 1998, WMI distributed a memorandum to Warner operating companies instructing that the company's discount campaign for 3T2 must end on July 31:

> The previously announced period of the Three Tenors mid price campaign has changed. This campaign must now finish July 31st. No further discounting or new marketing activities which are not already in place may occur between August 1st and October 15th.

CX 458 at 3TEN00017892; *See also* JX 73; O'Brien, Tr. 438.

2. Atlantic relays WMI's assent to PolyGram

150. On July 13, 1998, Anthony O'Brien (Atlantic/Warner) telephoned Paul Saintilan (Decca/PolyGram) to confirm that WMI was on board and that the moratorium on discounting and promoting the older Three Tenors recordings would be honored throughout Warner. JX 3; JX 2; O'Brien, Tr. 440-41. O'Brien further informed Saintilan that WMI had issued a directive instructing all Warner operating companies to observe the Three Tenors moratorium. JX 3; JX 2.

151. Saintilan independently confirmed (through a friend at Warner) that the directive had been issued throughout Warner. Saintilan was satisfied that the terms of the directive "complied perfectly" with his agreement with Warner. JX 4 at UMG000207.

3. PolyGram enforces the moratorium

152. Later that day, July 13, 1998, Saintilan forwarded an e-mail message to various PolyGram executives and managers describing his conversation with O'Brien, and informing them that the moratorium agreement was now securely in place at Warner:

> Tony O'Brien advised today that Ramon Lopez had issued the directive through Warner that they will observe the moratorium from August 1 through to October 15. The exceptions will be in markets where four weeks notice of a price change is required. Lopez . . . believes that they should police us, and we should police them. The prices should be "normal" and not subject to any special discounts or promotion.

JX 3.

The recipients of Saintilan's July 13 e-mail message include Chris Roberts (President, PolyGram Classics), Kevin Gore (Senior Vice President, PolyGram Classics in the United States), Rand Hoffman (Senior Vice President, PolyGram Holding), and Roger Lewis (President, Decca). JX 3.

153. On or about July 14, 1998, Paul Saintilan (Decca/PolyGram) distributed a memorandum to PolyGram operating companies worldwide "re-enforcing" the company's intention to comply with the moratorium:

> Ramon Lopez, the Chairman and CEO of Warner Music International issued a directive on July 13, that there should be no price discounting, advertising or promotion on the 1994 Warners Three Tenors album from August 1 until October 15. The only exceptions to this will be where legal obligations to retailers exist (such as four weeks notice of a price increase).
>
> We now seek to re-enforce the moratorium on PolyGram's side, from August 1 to October 15, on a worldwide, not simply European basis. The moratorium prohibits price discounting, advertising and promotion of the 1990 album and video during this period . . . .
>
> Should you find any evidence of Warners failing to comply with this agreement after August 1, please contact me providing as much detail as possible.

JX 4 at UMG000208; Saintilan Dep. (JX 94) at 171.

D. Intervention of PolyGram and Warner Attorneys

154. In late July 1998, after the Paris concert but prior to the release of 3T3, the legal departments of PolyGram and Warner became involved with the moratorium issue. F. 155, 160-63.

155. On July 17, 1998, Paul Saintilan forwarded his documents relating to the Three Tenors moratorium to PolyGram's General Counsel, Richard Constant. CX 459 at UMG SK 0001.

156. On July 30, 1998, Paul Saintilan forwarded a memorandum to PolyGram operating companies denying the existence of the moratorium agreement between PolyGram and Warner:

> Contrary to any previous suggestion, there has been no agreement with Atlantic Records in relation to the pricing and marketing of the previous Three Tenors albums.

JX 76 at UMG000213.

157. At trial, PolyGram executive Rand Hoffman acknowledged that Saintilan's statement that "there has been no agreement" was not correct. Hoffman, Tr. 367-68.

158. While disavowing the existence of a moratorium agreement, the July 30 memo also discourages any price discounting of 3T1:

> With immediate effect Decca has concluded that it is appropriate to adopt a flexible position that allows operating companies the chance to make their own commercial decisions on the optimum pricing of the 1990 album. We should emphasize, however, that in deciding how to market and price the 1990 album, operating companies should take full account of PolyGram's massive investment in the 1998 album and the need to maximize returns on this investment.

JX 76 at UMG000213.

159. Saintilan's July 30, 1998 memorandum was likely understood by managers at the PolyGram operating companies as a pretense. They received at least three previous memoranda advising that there was an agreement between PolyGram and Atlantic restricting the discounting of previous Three Tenors albums. JX 43 at UMG000479-480; JX 4 at UMG000208. Although the memorandum purports to give discretion over 3T1 pricing to the operating companies, they understood that they still could not discount 3T1 without the express consent of Decca and Bert Cloeckaert of PolyGram. Cloeckaert Dep. (JX 98) at 175-76; Stainer Dep. (JX 89) at 80-81; Hidalgo Dep. (JX 88) at 110.

160. Attorneys for Warner and PolyGram reviewed a draft letter from O'Brien to Saintilan purporting to reject the moratorium agreement for non-U.S. markets. RX 706 at UMG SK 0021; RX 707 at UMG SK 0027; RX 708 at UMG SK 0030.

161. On August 10, 1998, Anthony O'Brien was advised to sign and forward to Paul Saintilan a letter that the attorneys had drafted. O'Brien followed this advice. O'Brien, Tr. 452, 470.

162. The August 10, 1998 letter executed by O'Brien purports to reject the moratorium agreement, and asserts an intention to make unilateral decisions on pricing and promotion for 3T2. JX 81; O'Brien, Tr. 471.

163. On or about August 10, 1998, Anthony O'Brien had a final telephone conversation with Paul Saintilan regarding the moratorium agreement. O'Brien informed Saintilan that he (O'Brien) had been requested by counsel at Warner to send the August 10 letter. O'Brien further informed Saintilan that the August 10 letter notwithstanding, Atlantic and Warner Music International still intended fully to comply with the moratorium agreement. O'Brien, Tr. 470-71.

164. During the period August 1 through October 15, 1998, Anthony O'Brien understood that PolyGram was complying with the moratorium agreement. O'Brien, Tr. 472, 494-95.

E. Unfavorable Reviews

165. The 1998 Three Tenors album and video were released on August 18, 1998. O'Brien, Tr. 471.

166. Several music reviewers recognized the overlap in repertoire between the 1998 Three Tenors album and the earlier Three Tenors recordings. The Gazette (Montreal) (July 11, 1998) CX 575; The Seattle Times (Sept. 13, 1998) CX 580-B; The Boston Herald (Oct. 4, 1998) CX 579-B-C.

167. Published reviews of 3T3 were generally unfavorable: The San Francisco Chronicle (Oct. 4, 1998) CX 576; The Boston Globe at N1 (Oct. 4, 1998) CX 577-C; The Vancouver Sun at D12 (Sept. 26, 1998) CX 578-D; The Star-Ledger (Newark, NJ) (Sept. 26, 1998) CX 574-C; The Jerusalem Post at 9 (Sept. 2, 1998) CX 581-B.

F. Marketing Campaign for 3T3 in the United States

168. Warner treated 3T3 as a high-priority record, and the marketing campaign for 3T3 in the United States was well-funded and in all media. Moore, Tr. 71. Warner's marketing campaign for 3T3 during 1998 included: the PBS broadcast of the Three Tenors concert in Paris, release of a single ("You'll Never Walk Alone") and a music video, six foot tall stand up floor merchandisers in the shape of the Eiffel Tower, newspaper and magazine ads, store circular, prominent positioning in retail stores (*e.g.*, end caps, front counter displays, listening stations), radio spots, television ads, posters, mailers, New York City transit bus and rail ads, Access Hollywood feature to coincide with album release, E! Entertainment TV piece, and a web-site (featuring video interviews with the Tenors, conductor James Levine and Tibor Rudas, a tour of Pavarotti's dressing room and a fan bulletin board and chat room). CX 482-83. Warner's campaign for 3T3 in the United States included a cooperative advertising program with retailers that funded television and print advertisements. CX 483 at 3TEN00001423-

1424; CX 482; Moore, Tr. 74-76, 82-83. Warner coordinated in-store displays for 3T3 and advertisements with major record chains. CX 483 at 3TEN00001418-1419; CX 482. This involved nameboards, four-color lightboxes, six-foot-tall stand-up floor merchandisers in the shape of the Eiffel Tower, window displays, end caps and posters. CX 482 at 3TEN00009048; Moore, Tr. 72-73, 79-83. Warner launched a publicity campaign with radio stations, release of an electronic press kit, a website, and solicitation of articles and reviews. CX 483 at 3TEN001425-1426; Moore, Tr. 76-79. Warner arranged to have the single "You'll Never Walk Alone" delivered to radio stations nationwide. Moore, Tr. 77-79, 234-35; CX 483 at 3TEN00001426.

169. Warner sought to increase sales of 3T3 by offering discounts to customers. The initial discount in the United States for 3T3 was seven percent to wholesale customers, and five percent to retail customers. CX 483 at 3TEN00001418.

G. PolyGram and Warner Comply with the Moratorium Agreement in the United States

170. Atlantic (Warner) and PolyGram both complied with the moratorium agreement in the United States. O'Brien, Tr. 474-76.

171. Between August 1, 1998 and October 15, 1998, Atlantic (Warner) did not aggressively discount 3T2 in the United States; 3T2 was sold by Atlantic at full price only. O'Brien, Tr. 474.

172. Between August 1, 1998 and October 15, 1998, neither Atlantic (Warner) nor PolyGram funded advertising for 3T2 in the United States. O'Brien, Tr. 474; RX 728.

173. Between August 1, 1998 and October 15, 1998, Anthony O'Brien observed no discounting or advertising for 3T1 by PolyGram in the United States, and it was O'Brien's understanding that PolyGram was in fact complying with the moratorium. O'Brien, Tr. 476.

174. There is no evidence that during the moratorium period, PolyGram sold 3T1 at a discount price in the United States. *See* RX 713 at UMG004899-4900.

175. According to PolyGram's economic expert, Dr. Janusz Ordover, PolyGram's average wholesale price for 3T1 during the moratorium period (August/September/October 1998) was higher than the average wholesale price for 3T1 during the preceding three-month period (May/June/July 1998), and for the period August/September/October 1997. RX 716 (Ordover Expert Report) at ¶ 55.

176. Kevin Gore, Senior Vice President of PolyGram Classics during 1998 and currently President of Universal Classics, testified in his deposition that if he had found out that Warner was

discounting 3T2 during the moratorium period, PolyGram's pricing and discounting decisions for 3T1 could have been affected. Gore Dep. (JX 87) at 111, 113.

H. PolyGram and Warner Comply with the Moratorium Agreement Abroad

177. Warner complied with the moratorium agreement outside of the United States. O'Brien, Tr. 474; CX 453.

178. Between August 1, 1998 and October 15, 1998, Warner did not discount or advertise 3T2 outside of the United States. O'Brien, Tr. 474.

179. During the moratorium period, Warner's international operation (WMI) monitored PolyGram's prices for 3T1 outside of the United States. CX 450 at 3TEN00009904. If PolyGram were cheating on the agreement, then WMI wanted to respond by discounting and advertising 3T2. O'Brien, Tr. 476-77; CX 450 at 3TEN00009904.

180. Anthony O'Brien received no complaints from WMI during the moratorium period concerning PolyGram's marketing activities in support of 3T2. O'Brien, Tr. 476-77.

181. From August 1, 1998 through October 15, 1998, Warner perceived that PolyGram was substantially complying with the moratorium agreement outside of the United States. CX 204; O'Brien, Tr. 477.

I. Discounting on 3T2 After the Moratorium Expired

182. On October 2, 1998, Ramon Lopez (President, WMI) asked Val Azzoli (Co-Chairman, Atlantic) to contact PolyGram and discuss an orderly transition away from the moratorium. CX 204.

183. On October 15, 1998, the agreed-upon term for the Three Tenors moratorium came to an end. JX 3.

VII. EACH OF THE RESPONDENTS AND THE MORATORIUM

184. Respondent Decca, through its employees Paul Saintilan and Roger Lewis, agreed to the Three Tenors moratorium. F. 92, 95, 110-13, 137-47, 150.

185. Respondent UMG (formerly PolyGram Records), through its employees Chris Roberts (President, PolyGram Classics division) and Kevin Gore conceived the Three Tenors moratorium. Roberts supervised Paul Saintilan with regard to the moratorium. F. 83-89, 101, 108, 122, 152, 155.

PolyGram Records was responsible for the marketing for 3T1 in the United States, and it instructed PGD to comply with the moratorium. F. 15, 101.

186. Respondent PolyGram Holding, through its Senior Vice President Rand Hoffman, participated in the moratorium agreement. Hoffman attended the March 1998 meeting at which PolyGram and Warner first agreed to the moratorium. F. 91. Hoffman urged Warner to induce its operating companies to comply with the moratorium agreement. F. 122-25. Hoffman was responsible for the PolyGram/Warner collaboration, and corresponded with Warner about the moratorium agreement. F. 113, 144, 152. PolyGram Holding approved the actions of its subsidiaries PolyGram Records and PGD with regard to the moratorium.

187. Respondent UMVD (formerly PolyGram Group Distribution, or "PGD") participated in the moratorium in the United States by selling 3T2 at the conspiracy price during the moratorium period. Gore Dep. (JX 87) at 28-29; Caparro Dep. (CX 609) at 44-45. PGD executed the strategy developed by Decca and PolyGram Classic for marketing of 3T1 in the United States. F. 16-17, 101.

188. "PolyGram was a labyrinth of companies set for specific legal and tax purposes." Kronfeld Dep. (JX 86) at 15. In their dealings with Warner concerning the 3T3 and the moratorium, the PolyGram companies acted as a single entity. F. 65, 95-96, 124, 140.

189. Hoffman of PolyGram Holding, negotiated the moratorium with Warner on behalf of all of PolyGram. F. 65, 124.

190. Representatives from several different PolyGram companies (including Saintilan of Decca, Hoffman of PolyGram Holdings, and Roberts of PolyGram Records) attended the 3T3 meetings where the moratorium was discussed. F. 86, 91.

191. Decca's Saintilan sought approval for the moratorium from employees of PolyGram Records, including Chris Roberts. F. 127-28, 152, 155; JX 3-4. Saintilan corresponded regarding to the moratorium with PolyGram Holding's Rand Hoffman, and sought Hoffman's approval regarding the moratorium. F. 113.

192. PGD implemented the moratorium in the United States at the direction of Decca and PolyGram Records. F. 101.

193. Warner representative Anthony O'Brien understood that Paul Saintilan had the authority to agree to the moratorium on behalf of all of PolyGram. Saintilan believed that he was agreeing to the moratorium on behalf of all of PolyGram. F. 96, 140; JX 1-A-B.

194. As one of the entities responsible for the pricing of 3T1 in 1998, PolyGram Records had actual authority to determine the price of 3T1 charged by PGD in the United States. F. 15

195. As one of the entities responsible for the pricing of 3T1 in 1998, Decca had actual authority to determine the price of 3T1 charged by PGD in the United States. Gore Dep. (JX 87) at 98-99.

VIII. OTHER NEW THREE TENORS ALBUMS RELEASED WITHOUT RESTRAINTS

A. Sony's Three Tenors Recording Without a Moratorium

196. In 1999, Luciano Pavarotti was obligated by contract to record exclusively for PolyGram. CX 224 at UMG004248. In 1999, PolyGram agreed to waive its exclusive rights to the recording services of Pavarotti so as to permit Pavarotti to record a Three Tenors album for Sony. CX 515; CX 516.

197. In October 2000, Sony released an album derived from a performance of the Three Tenors in Vienna. The album is entitled *The Three Tenors Christmas*, and consists of Christmas songs from around the world. O'Brien, Tr. 482; Gore Dep. (JX 87) at 66-67.

198. Sony did not discuss with Warner restricting its competitive marketing activity in support of 3T2 and 3T3 at the time of the release of the 2000 Three Tenors album. O'Brien, Tr. 482.

199. Sony did not discuss with PolyGram restricting its competitive marketing activity in support of 3T1 and 3T3 at the time of the release of the 2000 Three Tenors album. Hoffman, Tr. 329.

B. In 1994, Warner Released 3T2 Without A Moratorium

200. In 1994, Warner controlled the rights to 3T2, while PolyGram controlled the rights to 3T1. Stip. ¶¶ 85, 90, 106. 3T2 was distributed and marketed by Warner without any agreement between Polygram and Warner concerning Polygram's pricing or marketing of 3T1. Stip. ¶ 149.

201. During 1994, the marketing of 3T2 was a priority for Warner. Moore, Tr. 89-90; CX 247 at 3TEN00011271; CX 241 at 3TEN000007230.

202. In its marketing campaign for 3T2, Warner anticipated that PolyGram would advertise and discount 3T1 when Warner released 3T2. CX 257; CX 249 at 3TEN00011254; CX 256 at 3TEN0004763, 4765-66; CX 258 at 3TEN00005402; CX 255; CX 244.

203. Warner's marketing effort was to differentiate 3T2 from 3T1. CX 259 at 3TEN00011109; CX 249 at 3TEN00011254-55; CX 242 at 3TEN00000441; CX 248 at 3TEN00011260.

204. Warner launched an aggressive and expensive international marketing campaign in support of 3T2. CX 247 at 3TEN00011271; O'Brien, Tr. 405-06; Hidalgo Dep. (JX 88) at 46-47; Stainer Dep. (JX 89) at 10.

205. Warner's marketing campaign for 3T2 in the United States was comprehensive and expensive. CX 243 at 3TEN00007150-58; Moore, Tr. 92-96; CX 251.

206. Warner offered compensation to secure prominent placement of 3T2 in music stores. CX 251at 3TEN0008888-89; CX 249 at 3TEN00011253; CX 259 at 3TEN00011110.

207. Warner's U.S. and European operating companies offered key accounts a five percent discount for all orders taken in advance of the first shipment. CX 253 at 3TEN00011247. Warner also developed promotional programs to increase initial sales, including the introduction of a gold CD. CX 260 at 3TEN00011224; CX 332.

208. In the United States, Warner established a distinct identity for 3T2, and had a successful launch. CX 261 at 3TEN00017820; CX 262 at 3TEN00017828; CX 263 at 3TEN00017843; CX 264 at 3TEN00017822; CX 265 at 3TEN00017852.

209. Tibor Rudas was pleased with Warner's "total commitment and aggressive promotion" of 3T2. CX 325 at UMG004698.

210. PolyGram did not sit back and permit the release of 3T2 to eclipse sales of 3T1. PolyGram developed an aggressive campaign to increase sales of 3T1, employing discounting and advertising. JX 29.

211. PolyGram instructed its opcos to promote the "original" Three Tenors concert and recordings as "unique and unrepeatable." CX 272 at UMG000524. *See also* CX 270 at UMG005050; CX 256 at 3TEN00004766.

212. During 1994, PolyGram launched a marketing campaign in support of 3T1 which distinguished this product through the use of product stickers, new posters, promotional discs for radio, and a deluxe edition. CX 283 at UMG005013; CX 272 at UMG000526-527; CX 271 at UMG005828; CX 270 at UMG005051. PolyGram used television advertising. CX 276 at UMG005033; CX 281 at UMG005028; CX 258 at 3TEN0005402-5403.

213. In the United States, PolyGram spent $109,471 in cooperative advertising for 3T1 during 1994. JX 103 at UMG006407. PolyGram spent most of this money (nearly $60,000) in September 1994, the month following the release of 3T2. JX 103 at UMG006407.

214. During 1994, PolyGram offered 3T1 at discounted prices. CX 275 at UMG005820; CX 256 at 3TEN0004766; CX 279 at UMG005031; CX 258 at 3TEN0005402; JX 44.

215. PolyGram reduced the wholesale price of 3T1 during 1994 by changing the list price to retailers; in some sales territories PolyGram moved 3T1 from the company's "top" price tier to the "mid-price" tier. *E.g.*, JX 32; CX 400; CX 428; CX 249 at 3TEN00011254.

216. PolyGram also offered special discounts, while maintaining the "top" tier designation for this album. In the United Kingdom, PolyGram ran a successful campaign called "Three Tenors for under a Tenner," in which 3T1 was offered for less than 10 pounds. CX 273; Stainer Dep. (JX 89) at 38. PolyGram's U.K. operating company offered these incentives without reducing the wholesale list price. CX 275 at UMG005820.

217. PolyGram provided cooperative advertising funds to retailers. This method was used in the United States. JX 103 at UMG006407. Cooperative advertising is a monetary commitment that the label makes to a retailer for positioning the album in a desirable location in the store or including the album in an out of store advertisement placed by the retailer. Kopecky Dep. (CX 610) at 21-22; Moore, Tr. 47-48, 58-59.

218. When PolyGram provides cooperative advertising funds, the retailer deducts the value of the cooperative advertising from the amount it pays for product purchased from PolyGram. Kopecky Dep. (CX 610) at 28-29. Cooperative advertising programs are a form of discount. **CX 603-P** (*in camera*).

219. In September 1994 – the first full month after the release of 3T2 – PolyGram spent $57,178 on cooperative advertising for 3T1 in the United States. JX 103 at UMG006407. During that same time period, PolyGram generated $630,738.00 in U.S. sales of 3T1. RX 713 at UMG004889. PolyGram returned to retailers through 3T1 cooperative advertising programs approximately nine percent of the money 3T1 generated.

220. Cooperative advertising funds create an incentive for retailers to place the advertised product on sale in order to move a higher volume of product. Moore, Tr. 67; JX 105-I (Moore Expert Report). When music companies provide cooperative advertising for their products, the retail price for consumers tends to decrease. Moore, Tr. 65-66; Gore Dep. (JX 87) at 79-80. It is likely that retail prices of 3T1 in the United States following the release of 3T2 were lower.

221. Warner observed later: "[I]n 1994, at the time of our release of the Three Tenors album, Decca dropped the price of their album to a midprice level. This was a temporary move by Decca to ensure sales of their recording at the time of our release of the 1994 album. At the end of 1994 Decca returned the pricing of the 1990 album back to the full line price." JX 32.

222. Competition from PolyGram notwithstanding, the 3T2 project was a business success for Warner. O'Brien, Tr. 406. *See also* CX 266 at 3TEN0009901. During 1994, Warner **[redacted** **]** achieved platinum sales on ship out of 3T2 in the United States and numerous other countries. **CX 394** (*in camera*); CX 260 at 3TEN00011224. 3T2 was the second-best selling classical album in the United States in 1994, and was the top-selling classical album in 1995. CX 587-88.

223. There is no evidence that Warner's spending in support of 3T2 was negatively affected by PolyGram's campaign for 3T1. In fact, the head of Warner's marketing campaign in the United Kingdom during 1994 (who later worked for PolyGram) testified in his deposition that PolyGram's 1994 campaign probably helped Warner's release. Stainer Dep. (JX 89) at 13-14; *see also* CX 249 at 3TEN00011254-55.

C. PolyGram and Warner Compete Directly and Aggressively During the Three Tenors World Tour

224. During 1996 and 1997, The Three Tenors had concerts in Tokyo, London, Munich, New York, Johannesburg, and Melbourne. Stip. ¶ 117. Warner and PolyGram capitalized on the opportunity to drive sales of their Three Tenors products. CX 289; Stip. ¶¶ 118-119; *see also* F. 225-34.

225. PolyGram offered 3T1 at a discounted price in many markets. CX 305 at 3TEN00004983; CX 307; CX 400.

226. In 1996, PolyGram released a World Tour Commemorative Edition of the 1990 concert, digitally re-mastered on a gold CD. PolyGram placed promotional stickers on the albums to draw consumer attention to the product enhancement. Stip. ¶ 121; CX 288 at UMG006106; CX 272 at UMG000526.

227. Warner viewed the 1996/1997 Three Tenors tour to be "a powerful marketing tool" and "an ideal opportunity to exploit our product and new variants again." Stip. ¶ 118; CX 294 at 3TEN00017902; CX 295 at 3TEN00005917; CX2 96 at 3TEN0005910.

228. In 1996, Warner issued a special "Three Tenors World Tour Edition" of 3T2, consisting of the original 1994 Three Tenors CD, new packaging, and a booklet of unpublished photographs and information about The Three Tenors. Stip. ¶ 120; CX 296 at 3TEN00005912; CX 299 at 3TEN00005904. Warner offered "[t]he concept of value added in the form of the slip case and celebratory photo book to counter the anticipated price cutting by Decca." CX 300 at 3TEN00008946. The slip case contained cover art different from that contained on the original 3T2 cover. CX 301; CX 302.

229. Warner instructed its operating companies to develop marketing plans for 3T2 that took advantage of the Three Tenors concert tour. CX 294 at 3TEN000017902; CX 293 at 3TEN011189; CX 299 at 3TEN0005903-04.

230. To counter PolyGram's marketing activities for 3T1, Warner's marketing campaign highlighted the advantages of the 1994 album. CX 299 at 3TEN00005903.

231. The Three Tenors performed in New York in July 1996. At that time, Warner launched a major television campaign in support of 3T2. CX 298 at 3TEN00010826.

232. At the time of the 1996 world tour, PolyGram assured Tibor Rudas that the rivalry between Warner and PolyGram would be beneficial for The Three Tenors:

> Warner and we [PolyGram] will fight head on for every inch of advantage we could possibly gain over each other in exploiting the 3T tour with our respective product. Fair enough, competition is good for the business . . . . Nevertheless, be assured the competition will be lively and the whole project will greatly benefit from it.

CX 309.

233. By 1996, Warner had sold more than eight million units of the 3T2 album and video, including more than two and a half million units in the United States. CX 306 at 3TEN00004902.

234. The Three Tenors albums, 3T1 and 3T2, were both among the best-selling classical recordings in the United States in calendar years 1994, 1995, 1996, and 1997. CX587-90.

IX. COMPETITIVE EFFECTS OF THE MORATORIUM AGREEMENT

235. PolyGram and Warner agreed that each would not to discount 3T1 and 3T2. JX 104-B (Stockum Expert Report); Stockum, Tr. 586.

236. When horizontal competitors enter into an agreement to restrict price competition, the potential adverse effect is obvious. Stockum, Tr. 583085; JX 104-B (Stockum Expert Report). Complaint Counsel's economic expert, Dr. Stephen Stockum, testified at trial that the potential effect of an agreement between competitors not to discount includes a loss to consumer welfare and to allocation efficiency. Stockum, Tr. 583-85; JX 104-B (Stockum Expert Report).

237. Dr. Stockum concluded that, absent an efficiency justification, an agreement not to discount is very likely to be anticompetitive. Stockum, Tr. 581-86.

238. Price discounting is a marketing tool in the recorded music industry. Moore, Tr. 44-45, 65-68; Stockum, Tr. 600-02.

239. PolyGram and Warner offer discounts to retailers in order to increase sales levels. This principle applies to the sale of catalogue products as well as new releases. O'Brien I.H. (JX 101) 82; **O'Brien Dep. (JX 100) at 91-92** (*in camera*); Caparro Dep. (CX 609) at 49-50, 33, 43-44;

Kopecky Dep. (CX 610) at12; Cloeckaert Dep. (JX 97) at 25-26; Stainer Dep. (JX 89) at 9-10; Greene Dep. (JX 95) at 58; Saintilan Dep. (JX 94) at 69-70.

240. During 1994, PolyGram responded to the release of 3T2 by aggressively reducing the price of 3T1 in many markets. F. 214-21.

241. In 1996 and 1997, PolyGram offered discounts on 3T1 in order to compete with Warner's marketing of 3T2 and its special World Tour Edition. CX 308; F. 224-32.

242. In 1998, many PolyGram and Warner operating companies determined that the best way to capitalize upon the public's revived interest in the Three Tenors was by dramatically reducing the price of these products (with aggressive advertising campaigns). F. 103-05, 115-18.

243. In 1998, both PolyGram and Warner requested and received assurances that the other would abide by the moratorium on discounting. F. 84, 107-13, 121, 126, 130, 132, 137-43, 147-48, 152-53.

244. Consumers consider price in their decisions to purchase classical music. CX 540 at UMG006114; CX 541 at UMG006151.

245. Information disseminated through advertising educates consumers about the availability and quality differences among competing products, sales locations, means of purchase, and pricing. This information promotes low prices and competition. JX 104-C (Stockum Expert Report); Stockum, Tr. 587-92; Moore, Tr. 53-54, 59, 62-64.

246. Economists have studied the effect of advertising restrictions in numerous industries. These studies conclude that advertising restrictions result in consumers paying higher prices. JX 104-C-D (Stockum Expert Report); Stockum, Tr. 592-600. In the absence of the ability to advertise a low price, a firm has less incentive to charge a low price. Stockum, Tr. 589-92; Ordover Dep. (JX 90) at 49.

247. Dr. Stockum considered these studies in his expert opinion. JX 104-C-D (Stockum Expert Report); Stockum, Tr. 592-600. One study that showed that advertising bans of a short duration can lead to higher prices; it involved a newspaper strike in New York, where supermarkets advertised heavily. For about a 60 day period, there were no advertisements in Queens, while in neighboring Nassau County a different paper continued to operate. The author found that the prices rose by 5.8 percent during the very first week of the strike. Stockum, Tr. 599-600; Amihai Glazer, *Advertising, Information and Prices – A Case Study*, 19 Econ. Inquiry 661 (1981).

248. On the basis of economic theory and empirical findings, Dr. Stockum concluded that, absent an efficiency justification, Respondents' agreement not to advertise or promote catalogue Three

Tenors albums is very likely to be anticompetitive. JX 104-D (Stockum Expert Report); Stockum, Tr. 587-92, 616-17.

249. Respondents' economic expert, Dr. Ordover testified at his deposition that naked agreements between competitors not to advertise their respective products "are likely to be adverse to consumers." Ordover Dep. (JX 90) at 47.

250. Advertising is an important basis of rivalry in the recorded music industry. Moore, Tr. 59; Stockum, Tr. 601-02; Caparro (CX 609) at 59; Kopecky Dep. (CX 610) at 50; Gore Dep. (JX 87) at 90.

251. Music companies spend huge amounts of money advertising recorded music products in the United States. Caparro Dep. (CX 609) at 57, 59; O'Brien I.H. (JX 101) at 12-13.

252. Between July 1994 (release of 3T2) and August 1998 (moratorium), aggressive and successful advertising campaigns were run separately by Warner and Polygram to increase sales of their respective Three Tenors products. F. 103-07, 115-18, 200-34.

253. In 1994 and thereafter, PolyGram used advertising to tell consumers that 3T1, was still the best performance and was still widely available at a discounted price. F. 210-18; *see also* JX 12 at UMG005007; Stainer Dep. (JX 89) at 38-39; Cloeckaert Dep. (JX 97) at 81.

254. In 1994 and thereafter, Warner used advertising to create a distinct identity for 3T2, and to suggest that it was the superior product. F. 200-09; *see also* CX 259 at 3TEN00011109; CX 249 at 3TEN00011254-55; CX 254 at 3TEN0005589-0005590; Stainer Dep. (JX 89) at 10-11; Stainer Dep. (JX 89) at 17-18.

255. During 1998, Warner proposed to Tibor Rudas an aggressive marketing campaign for 3T2. Warner's strategy was "to aggressively advertise, position, and discount price the 1994 album." JX 31 at 3TEN00009930; JX 7 at 3TEN00001492; O'Brien I.H. (JX 101) at 99-100; JX 29 at 3TEN00003592; JX 32 at 3TEN000011058.

256. Warner forecast that by cutting the wholesale price of 3T2 and advertising on television and in other media, the company could increase sales by 170 percent and increase overall profits as well. CX 396 at 3TEN00011072; JX 31 at 3TEN00009930.

257. During 1998, PolyGram authorized its operating companies to sell 3T1 at significantly discounted prices, supported by an advertising campaign. JX 41 at UMG003075; JX 43 at UMG000479-481; CX 413 at UMG003058.

258. PolyGram's operating companies forecast substantial additional sales of 3T1 if they were permitted to discount and advertise. JX 35; Cloeckaert Dep. (JX 97) at 57-58; JX 50 at UMG003746; CX 427.

259. Advertising of recorded music creates demand, and discounting by music companies is more likely to occur. Stockum, Tr. 589-91; JX 104-C (Stockum Expert Report) at ¶ 8; Ordover Dep. (JX 90) at 49; Caparro Dep. (CX 609) at 55-56; *see also* Cloeckaert Dep. (JX 97) at 23-24, 52-53 ; Saintilan Dep. (JX 94) at 71; Moore, Tr. 64-65, 67.

260. When music companies advertise their products, the retail price for consumers tends to decrease. Moore, Tr. 65-66; Gore Dep. (JX 87) at 79-80.

261. Respondents chose a moratorium on discounting and advertising in order to achieve their goal of limiting the sales of 3T1 and 3T2. Stockum, Tr. 614.

X. EFFICIENCY JUSTIFICATION

A. Purpose of the Collaboration

262. During the hearing, Respondents stipulated that the Three Tenors moratorium was not necessary to the formation of the PolyGram/Warner collaboration:

> MR. PHILLIPS: First of all, Your Honor, we have never contended that the moratorium agreement was necessary to the formation of the joint venture. The moratorium agreement, the evidence suggests, was not discussed before the formation of the joint venture. That's simply a nonissue in the case, Your Honor.
>
> JUDGE TIMONY: Okay.
>
> MR. PHILLIPS: [The President of PolyGram Classics] did approve the deal, but the moratorium agreement hadn't been discussed at the time he approved the deal, so how could he know, remember something that hadn't occurred.
>
> JUDGE TIMONY: You'd stipulate that?
>
> MR. PHILLIPS: That the moratorium agreement hadn't been entered into before the joint venture was formed?
>
> JUDGE TIMONY: And was not necessary to the agreement.
>
> MR. PHILLIPS: It wasn't necessary to their entering into the deal, correct.

JUDGE TIMONY: Because they hadn't discussed it.

MR. PHILLIPS: Because they didn't discuss or even think about it. Because they didn't discuss or even think about it.

PHC Tr. 83-84.

263. PolyGram and Warner executed the written contract for 3T3 on December 19, 1997, months before entering into the moratorium agreement. *Compare* JX 10 *with* JX 5 at UMG001527; *and* CX 388 at 3TEN0008009 (same). PolyGram and Warner were committed to the formation of the PolyGram/Warner collaboration, the production of the Paris concert, the creation of 3T3, and the distribution of 3T3 in the United States well before discussions of the moratorium even commenced. The moratorium was not necessary for the 3T3 project.

264. If no moratorium on competition had been agreed to by PolyGram and Warner, Warner would still have distributed 3T3 in the United States; Warner was not going to walk away from its $9 million investment. O'Brien, Tr. 446-47; Stockum, Tr. 623. Respondents estimate that the moratorium made only a small contribution to the value of the PolyGram/Warner collaboration. RX 716 (Ordover Expert Report) at ¶ 35; Stainer Dep. (JX 89) at 46, 49-51; Saintilan Dep. (JX 94) at 106.

265. At the time that PolyGram and Warner executed their agreement to collaborate on the distribution of 3T3, the firms retained the unconstrained right to exploit their respective Three Tenors catalogue products, 3T1 and 3T2. JX 10 at UMG001843-844. PolyGram's rights to 3T1 pre-date the arrangement and were not part of the collaboration for 3T3.

266. PolyGram's U.S. marketing operation was not involved in the 3T3 collaboration, and thus was not used efficiently for the betterment of the collaboration. Gore Dep. (JX 87) at 59, 60.

267. PolyGram's U.S. distribution assets were uninvolved in the distribution of 3T3. Caparro Dep. (CX 609) at 24-25, 39-40.

268. The parties were concerned that 3T3 might lose sales to 3T1 and 3T2. O'Brien, Tr. 490.

269. The parties were concerned that competition among Three Tenors products may adversely affect the profitability of the 3T3 project. Anthony O'Brien, the Warner executive responsible for the moratorium agreement, testified at trial that the purpose of the moratorium was to prevent consumers from selecting a lower priced alternative to 3T3. O'Brien, Tr. 485-87.

270. Warner received no profit from sales of 3T1 (owned by PolyGram), a smaller profit from each sale of 3T2 (substantial royalty owed to Rudas), and a larger profit from each sale of 3T3. O'Brien, Tr. 406; Hoffman, Tr. 300-01. Warner did not want consumers to compare the recordings

and to determine that a catalogue Three Tenors album "is just fine for a few dollars less." O'Brien, Tr. 485-87.

271. Rand Hoffman, PolyGram's representative in the United States also testified that the function of the moratorium was to deter consumers from purchasing 3T1 and 3T2, with the expectation that such consumers would by default select 3T3. Hoffman I.H. at 43.

272. This strategy, Hoffman expected, would protect the venturers' investment in the new Three Tenors album. Hoffman I.H. at 47.

273. Paul Saintilan, the PolyGram manager responsible for negotiating the moratorium agreement, testified at his deposition that the purpose of the moratorium was that without it: "consumers would choose, instead of buying the new album, to take advantage of the cheaper price of the old album and buy the old album." Saintilan Dep. at 90; *see also* JX 9-A.

274. Chris Roberts, the President of PolyGram Classics during 1998, professed not to know the purpose of the moratorium. Roberts Dep. (JX 93) at 141-45.

275. Stephen Greene was identified as a witness for the efficiency justifications proffered by Respondents. Stip. ¶ 64. He was unable to identify any risks to 3T3 if the older albums were promoted around the time of the release of 3T3. Greene Dep. (JX 95) at 192-94.

B. Free-Riding

276. The assumption underlying the free-riding defense is that "[s]ome consumers who come to the store, because of the promotion of the 1998 Album and intending to buy that album, may [in the absence of the moratorium] be attracted by the cheaper 1990 and 1994 albums and buy them instead." RX 717 (Wind Expert Report) at ¶ 5(b). There is potential consumer harm only if the free-riding is so pervasive that Warner declined to advertise 3T3 in an appropriate manner at the time that the album was released. *See* RX 716 (Ordover Expert Report) at ¶ 30-32; Stockum, Tr. 624, 730, 739-41.

1. Diversion of sales

277. That advertising for one product may benefit another company's product is a ubiquitous phenomenon. Stockum, Tr. 625-26, 629, 633; CX 612 (Stockum Rebuttal Expert Report) at ¶ 17; Wind Dep. (JX 91) at 126-27.

278. Respondents' expert, Dr. Wind, testified in his deposition that there are "tons of examples" of one firm capitalizing upon the marketing activities of a competitor. Wind Dep. (JX 91) 133-34. Dr. Wind explained that sellers generally respond to this challenge by sharpening their

marketing campaigns, and by using advertising and other marketing tools to create a distinct identity for the target product. Wind Dep. (JX 91) at 125-29.

279. The "spillover" effect of advertising is a "fact of life" and the prospect of free-riding does not lead sellers of consumer products to abandon advertising. Stockum, Tr. 635-36; CX 612 (Stockum Rebuttal Expert Report) at ¶ 17; Kopecky Dep. (CX 610) at 55; Caparro Dep. (CX 609) at 85.

280. Within the recorded music industry, advertising intended to benefit one album often leads to sales of competing albums. RX 716 (Ordover Expert Report) at ¶ 36; Ordover Dep. (JX 90) at 130; Cloeckaert Dep. (JX 98) at 122-23; Moore, Tr. 59.

281. A strong, popular album creates spillover effects that are beneficial to the entire recorded music industry. For this reason, both labels and retailers often blame slow overall store traffic on the absence of heavily-advertised major new releases during a particular fiscal quarter. JX 105-F (Moore Expert Report) at ¶ 23; Cloeckaert Dep. (JX 97) at 46; Kopecky Dep. (CX 610) at 52-54; Caparro Dep. (CX 609) at 83-85.

282. In 1994, as Warner was preparing to market 3T2, it anticipated competition from PolyGram (3T1). F. 200, 202.

283. Warner advertised 3T2, and did not enter into a moratorium with its rival. F. 200-09.

284. Instead, Warner devised a marketing campaign aimed at convincing consumers that 3T2 was preferable to 3T1. F. 203. The company's marketing campaign for 3T2 was a success and 3T2 was profitable. F. 222, 223.

285. In 1996 and 1997, Warner was anxious to distribute 3T3 independently, with no prospect of a moratorium with PolyGram. CX 321 at 3TEN00004277.

286. In 1996 and 1997, PolyGram (certainly aware of its own marketing activity in 1994), was anxious to distribute 3T3 independently, with no prospect of a moratorium with Warner. CX 323 at UMG000487-88; CX 324 at UMG004669; CX 327 at UMG004679. Other music companies also were interested in distributing 3T3, with no prospect of a moratorium with PolyGram and Warner. CX 317.

287. The fourth Three Tenors album, Three Tenors Christmas, was produced and marketed by Sony in 2000 without restricting competition from 3T1, 3T2 or 3T3. F. 197-99.

288. Advertising in support of 3T3 would not have been curtailed on account of free-riding. Stockum, Tr. 637-38. Witnesses representing both Warner and PolyGram testified that 3T3 would

have been promoted without the moratorium, and that the moratorium had no effect on the resources for advertising and promoting 3T3. "I think that 3T3 would have been appropriately marketed and promoted in the United States without regard for the moratorium with PolyGram." O'Brien, Tr. 490. *See also* O'Brien, Tr. 448; Roberts Dep. (JX 92) at 50-52.

289. Paul Saintilan testified that PolyGram's advertising budget for 3T3 was determined in January or February 1998, before the moratorium was agreed upon. After February 1998, there was little opportunity for PolyGram to increase or decrease marketing expenditures for 3T3. And even if there were such an opportunity, PolyGram did not view competition from Warner as a rationale for altering its advertising expenditures. Saintilan Dep. (JX 94) at 88-89; Saintilan Dep. (JX 94) at 194-95.

290. In June 1998, when it appeared to PolyGram that the Three Tenors moratorium would fall apart, PolyGram did not alter its marketing strategy or cut back on its advertising budget. The company notified its operating companies that if Warner was found selling 3T2 at discounted prices in any territory, then the local PolyGram operating company could respond by discounting 3T1. F. 129, 130.

291. Before the moratorium, PolyGram executives were not concerned that PolyGram operating companies would not use their best efforts to promote 3T3 at the time of the launch, regardless of whether they were allowed to discount 3T1 or Warner discounted 3T2. Greene Dep. (JX 95) at 89-90, 189-90.

2. Free-riding defense

292. In 1998, PolyGram and Warner did not quantify the extent to which consumers drawn to record stores by promotion for 3T3 would (absent the moratorium) have purchased 3T1 or 3T2. O'Brien, Tr. 491; Saintilan Dep. (JX 94) at 82.

293. That PolyGram or Warner executives may have been concerned that 3T3 may lose sales to 3T1 and 3T2 is not a reliable gauge of the magnitude of the free-riding effect. Cloeckaert Dep. (JX 97) at 42-43.

294. Dr. Ordover calculated that absent the moratorium agreement the sales diverted from 3T3 to 3T1 in the United States due to free-riding during the moratorium period (August - October 1998) would have been small (less than $86,000 per month). RX 716 (Ordover Expert Report) at ¶ 35; Ordover Dep. (JX 90) at 158. Dr. Ordover was unable to conclude that free-riding in the United States would have had a significant impact on the venturers' incentives to advertise 3T3. Ordover Dep. (JX 90) at 158-59.

295. Dr. Ordover acknowledged that discounting and promotion of 3T1 by PolyGram might increase Warner's incentive to promote 3T3. Ordover Dep. (JX 90) at 115-16, 118-19.

296. Dr. Ordover testified that he "cannot answer the question" whether the moratorium was reasonably necessary for the efficient marketing of 3T3 in the United States. Ordover Dep. (JX 90) at 55. He does not conclude that free-riding was a significant problem for PolyGram and Warner in the United States – only that it was a plausible concern. Ordover Dep. (JX 90) at 66; Ordover Dep. (JX 90) at 36-37. Dr. Ordover did not consider any less restrictive alternatives to the moratorium. Ordover Dep. (JX 90) at 77.

297. Although Dr. Ordover's report states that the moratorium is "reasonably necessary" to avoid free-riding (apparently outside the United States), he defines "reasonably necessary" as meaning plausible, or not obviously pretextual. Ordover Dep. (JX 90) at 50-51.

298. Dr. Ordover contends that "a quick look of restraints would be best left for those joint ventures that are a sham." He further argues that any restraint related to a legitimate joint venture should be analyzed under the fullest rule of reason. Ordover Dep. (JX 90) at 44. As a result, Dr. Ordover did not determine whether the restraint in this case actually promoted the efficient operation of the venture, or whether the efficiency justifications were valid.

299. For these reasons Dr. Ordover's testimony is given little weight.

3. Sharing of advertising expenses

300. A method of addressing a free-riding problem associated with advertising is to ensure that all those who benefit from such advertising contribute toward the funding for the advertising. CX 612 (Stockum Rebuttal Expert Report) at ¶ 25; Stockum, Tr. 816-18; Ordover Dep. (JX 90) at 94, 96.

301. The collaboration agreement between Warner and PolyGram provides that the two music companies shall each be entitled to 50 percent of the net profits and net losses derived from sales of 3T3 worldwide. Any advertising or marketing expenses incurred by either party are to be deducted from revenues for purposes of calculating net profits (losses). Every dollar spent in the United States by Warner to promote 3T3 is partially reimbursed by PolyGram; fifty cents comes from each of the venturers. Stockum, Tr. 735; JX 10-Q at UMG001072; JX 10-I at UMG0001075; O'Brien, Tr. 419-20; CX 348 at UMG002158; JX 20; CX 532 at 3TEN00009949; CX 533; CX 534 at UMG000577.

302. If the proportional benefit to each party of the advertising is equivalent to the proportional cost of advertising borne by each party, then there is no distortion of incentives. For example, if Warner paid 50 percent of the cost of advertising 3T3, and received 50 percent of the benefit that is an efficient arrangement. Stockum, Tr. 819-20; Ordover Dep. (JX 90) at 114-15.

303. If the forecasted benefit to PolyGram and Warner from advertising 3T3 were not equal, then the parties could have altered the cost-sharing mechanism accordingly. For example, if Warner were expected to gain 52 percent of the benefit of the advertising, then the parties could have agreed that Warner would pay 52 percent of the cost. Stockum, Tr. 820-21.

304. It is efficient for PolyGram and Warner to allocate advertising costs based upon forecast (rather than actual) sales levels because Warner's advertising expenditures in support of 3T3 in the United States were also based upon forecast rather than actual sales levels. Stockum, Tr. 820-22; CX 321 at 3TEN00004279; Saintilan Dep. (JX 94) at 88-89, 194-95; O'Brien, Tr. 542; 401.

305. If PolyGram and Warner were unable to make a reasonably reliable forecast regarding the relative benefits from advertising 3T3, then each party's contribution to the advertising of 3T3 could have been determined by the parties after the launch of 3T3. Stockum, Tr. 822-23.

4. Free-riding in the United States

306. Respondents' economic expert, Dr. Ordover, opined that if there were any serious free-riding problem in connection with the marketing of 3T3, it existed in Europe, but not the United States. Ordover Dep. (JX 90) at 36-37; Ordover Dep. (JX 90) at 25, 27.

307. There is no evidence that, during the moratorium period, discounted copies of 3T1 and 3T2 would have been resold, or transshipped, from the United States to Europe.

308. PolyGram considered transshipment to be a problem only within Europe. When PolyGram ran a campaign to discount 3T1 during June and July 1998, it was concerned about ensuring that prices in Europe were roughly equivalent, or "harmonize[d]." JX 40. No effort was made to "harmonize" prices between Europe and the U.S. Cloeckaert Dep. (JX 97) at 12-13; Gore Dep. (JX 87) at 24.

5. Making 3T3 more distinct from 3T1 and 3T2

309. Firms generally respond to spillover by "emphasiz[ing] the uniqueness of their offering." Wind Dep. (JX 91) at 127, 129.

310. Dr. Ordover acknowledged that the free-riding problem would be ameliorated if 3T3 were more distinct from 3T1 and 3T2, in repertoire and appearance. Ordover Dep. (JX 90) at 126, 130, 144; RX 716 (Ordover Expert Report) at ¶ 16.

311. In 1994, Warner used the tools of marketing (*e.g.,* packaging, advertising) to create a unique identity for 3T2, distinct from 3T1. F. 203-08. A similar strategy could have been pursued for 3T3 in 1998. Moore, Tr. 123-35.

C. Consumer Confusion

312. Paul Saintilan was concerned that consumers would find it confusing to choose among three different Three Tenors albums. This concern was not based upon research, data, or observation. Saintilan Dep. (JX 94) at 81-82.

313. There is no evidence that consumers were confused in selecting among the Three Tenors albums. Hidalgo Dep. (JX 88) at 84-85. It was "speculation." Greene Dep. (JX 95) at 193, 195; Stainer Dep. (JX 89) at 42-43.

314. PolyGram designed the cover art for 3T3 and could have designed packaging for 3T3 that was distinct from the older Three Tenors products. CX 500; CX 501; CX 502; CX 503; CX 505; CX 508; *see also* JX 5 at UMG001523-001524; JX 26 at UMG000372; CX 383 at UMG003284.

315. There was no confusion between 3T1 and 3T2 prior to the release of 3T3. Stainer Dep. (JX 89) at 12-13, 19-20; Hidalgo Dep. (JX 88) at 22-24.

316. In 1994, PolyGram and Warner distinguished their respective Three Tenors products by slip case covers (a type of CD packaging), enhanced photo books, and product stickers. CX 272 at UMG00526; CX 288 at UMG006106; CX 296 at 3TEN00005912; CX 299 at 3TEN00005904; CX 300 at 3TEN00008946; *see also* Moore, Tr. 127-35.

317. Advertising campaigns for 3T1 and 3T2 could have differentiated these products from the new Three Tenors release. This was done in 1994 to distinguish 3T2 from 3T1. Stainer Dep. (JX 89) at 21; CX 249 at 3TEN00011254; CX 259 at 3TEN00011108.

318. Discounting of 3T1 and 3T2 also could have differentiated these products from the new Three Tenors release. Saintilan Dep. (JX 94) at 91-92.

319. Consumer confusion comes from the retail display of the albums. Saintilan Dep. (JX 94) at 91. If products are displayed appropriately, discounting need not lead to consumer confusion. Saintilan Dep. (JX 94) at 92.

320. Record retailers display their products to avoid confusing consumers. Saintilan Dep. (JX 94) at 83; Caparro Dep. (CX 609) at 70-71.

321. PolyGram and Warner could have remedied any consumer confusion by requesting that retailers display 3T3 separately from 3T1 and 3T2. Saintilan Dep. (JX 94) at 84-85.

322. Warner could have secured commitments from retailers that 3T3 would be positioned prominently in the stores, and that 3T1 would not be positioned alongside 3T3. CX 612 (Stockum Rebuttal Expert Report) at ¶ 30; Stockum, Tr. 793-94; Wind Dep. (JX 91) at 81-86. Warner could have prevented any CD other than 3T3 from being placed in the special Eiffel Tower display it provided to retailers. O'Brien Dep. (JX 100) at 82. Record companies have been able to achieve exclusive space in retail stores. CX 249 at 3TEN00011253; Caparro Dep. (CX 609) at 66-67; Kopecky Dep. (CX 610) at 36-37, 64; Moore, Tr. 52, 261-62.

1. Respondents' evidence of consumer confusion

323. Respondents' expert witness, Dr. Yoram Wind, opined that it is theoretically possible that some consumers faced with too much variety may elect to postpone their purchase because they are not yet certain of the relative merits of the various products. Wind Dep. (JX 91) at 20-22, 131-33. However, the theory is premised upon "small studies" that are "not necessarily generalizable to the whole population." Wind Dep. (JX 91) at 25. Dr. Wind does not know how many, if any, consumers would find the offering of three albums so confusing that they buy none. Wind Dep. (JX 91) at 23.

D. Commercially Sound Marketing Strategy

324. Respondents' executives conclude that disappointing sales of 3T3 were probably attributable to the "tiring of the concept more than anything else." Cloeckaert Dep. (JX 97) at 73-74; *see also* Stainer Dep. (JX 89) at 74; Hidalgo Dep. (JX 88) at 91, 60-61; Saintilan Dep. (JX 94) at 35-37; Ordover Dep. (JX 90) at 147.

325. Respondents' expert, Dr. Wind argues that the moratorium was "sound commercial strategy." Dr. Wind's opinion assumes that 3T1, 3T2, and 3T3 are a single product line. Wind Dep. (JX 91) at 78. Dr. Wind assumes that, when marketing a product line, the goal is to target the various products to different segments of the market. Wind Dep. (JX 91) at 77-78. However, Dr. Wind's essential assumption is inconsistent with the facts of the case – where Warner and PolyGram specifically retained their rights to exploit 3T1 and 3T2. F. 61-62.

326. Dr. Wind did not review the evidence in this case to determine if the moratorium was necessary, as opposed to merely theoretically or "plausibly" necessary. Wind Dep. (JX 91) at 10-11.

327. Dr. Wind has not studied, worked in, or consulted for the recorded music industry. Wind Dep. (JX 91) at 5.

328. Professor Catherine Moore, an expert in the marketing of recorded music products who testified at trial, explained that while it may be useful to market recorded music products by one artist together, this is not necessary because a new release must be given its own unique identity and form its own message to consumers. Moore, Tr. 139.

329. Unlike Dr. Wind, Professor Moore has substantial first hand experience in marketing music products. Based upon her demeanor and experience I found her testimony to be particularly credible. Professor Moore is the director of the music business program at New York University, and is also a professor in that program. The music business program is an academic program that trains students for careers in the music industry, particularly in marketing, advertising, and promotion. Professor Moore teaches courses that focus on marketing and pricing issues in the recorded music industry and consults in that field. In addition, Professor Moore has nearly 20 years of experience working in the recorded music industry in retail music stores, distribution companies and for labels. Moore, Tr. 8-18.

330. For these reasons, Dr. Wind's opinions about the "necessity" of a "commercially sound" strategy are given little weight.

XI. RISK OF RECURRENCE

331. It is not unusual for an artist to release material on more than one label. Moore, Tr. 85; Hoffman, Tr. 293-94; Gore Dep. (JX 87) at 68-69; Caparro Dep. (CX 609) at 76; Constant Dep. (JX 96) at 97; CX 604-D. Examples of artists that have switched from one label to another include Janet Jackson, Mariah Carey, Rod Stewart, Placido Domingo, Jose Carreras, Vladimir Horowitz, Daniel Barenboim and Leonard Bernstein. Moore, Tr. 85-87. Other examples identified by PolyGram witnesses include Terry Dexter and Fabulous (Hoffman, Tr. 293-94); Elton John and Willie Nelson (Caparro Dep. (CX 609) at 73-74); and Miles Davis, George Benson, Sarah Brightman, Peter White,

and Keith Jarrett (Gore Dep. (JX 87) at 63-64, 68-69). Since it is common for an artist to record for more than one label over time, many artists have catalogue albums that appear on a label different from the label that releases the artist's new records. Moore, Tr. 85-89. When that occurs, the same incentives to enter into an agreement not to compete will exist that caused PolyGram and Warner to enter into the Three Tenors moratorium agreement.

332. It is common for one music company to "release" an exclusive artist to a competing company for purposes of a particular project. Moore, Tr. 39-40. The music company that receives the services of another company's exclusive artist, may reciprocate by releasing one of its exclusive artists for a future project. CX 513; CX 515; CX 516.

333. A music label may release an artist from his exclusive recording contract in return for a royalty on the artist's first album on his new label. When this occurs, the two competing labels have a shared financial interest in the success of a particular album. Hoffman, Tr. 357. Unless enjoined, Universal may seek a moratorium agreement to limit discounting or advertising of an artist's catalogue items on a competitor's label where it has obtained a release to have that artist perform for it.

334. Universal Music Group and Sony Music Entertainment have formed a joint venture to distribute music over the Internet. Universal, Sony, and other music companies will provide their music to the venture, known as "pressplay" on a non-exclusive basis. Accordingly, the music products marketed by the joint venture may also be marketed through traditional retail outlets. CX 553.

LEGAL ANALYSIS

I. SUMMARY OF FACTS

A. Joint Venture

The Three Tenors released three audio and video recordings from three concerts at three World Cup final games. F. 4-5. They first performed together at the Baths of Caracella in Rome during the summer of 1990. F. 27. PolyGram acquired the rights to distribute audio and video recordings of the concert. F. 28. The 1990 Three Tenors album ("3T1") became the best selling classical record of all time. F. 29.

In 1994, the Three Tenors planned a second World Cup performance at Dodger Stadium in Los Angeles. F. 31. Concert promoter Tibor Rudas offered PolyGram a license for the rights to the concert. F. 32. They did not agree upon terms, and Rudas instead authorized Warner to distribute audio and video recordings derived from the 1994 Three Tenors concert ("3T2"). F. 33.

PolyGram reacted to Warner's new album. F. 210. In response to the release of 3T2, PolyGram advertised that 3T1 was the "original" Three Tenors recording – "unique and unrepeatable," F. 211, and marketed 3T1 at a discounted price, several dollars below the price of Warner's 3T2. F. 214-21.

Warner supported the release of 3T2 with a "high-power pop marketing effort," F. 202-04; CX 247, advertising the new album in newspapers and magazines, on television and billboards, and with elaborate in-store displays. F. 205. Warner offered retailers discounts on 3T2, and worked to secure prominent placement for the album within music stores. F. 206-07. A PolyGram executive described Warner's marketing of 3T2 as "the most impressive campaign I have seen in my days." Hidalgo Dep. (JX 88) at 46-47; F. 204. The 3T2 project was a commercial success for Warner. F. 222. Warner did not seek or secure a moratorium on competition. F. 200.

During 1996 and 1997, the Three Tenors participated in a worldwide tour. F. 224. Warner and PolyGram used the opportunity to drive sales of their respective Three Tenors products. F. 224. PolyGram offered 3T1 at discounted prices. F. 225. In addition, PolyGram released a World Tour Commemorative Edition of the 1990 concert, digitally re-mastered on a gold CD. F. 226. Warner's marketing campaign emphasized the virtues of 3T2 and downplayed the benefits of PolyGram's offering ("The digital re-mastering will be detectable by very few. . . . The so called 'Gold' disc is almost certainly not real gold."). F. 230.

Consumers benefitted from the price discounts, promotions, and product enhancements that flowed from this unrestrained competition. F. 232; CX 309. Both of the Three Tenors albums were among the best-selling classical recordings in the United States in 1994, 1995, 1996, and 1997. F. 234.

B. Collaboration on 3T3

During 1996, Tibor Rudas approached PolyGram and Warner separately to discuss the next Three Tenors project, a huge open-air concert in front of the Eiffel Tower to coincide with the World Cup finals in Paris in July 1998. F. 51. Both music companies were interested in acquiring the right to distribute the 3T3 products. F. 52-54.

In the spring of 1997, the Chairman of Atlantic Recording Corp. (a Warner subsidiary based in the U.S.) met with his counterpart at PolyGram "to ask that PolyGram allow Luciano Pavarotti to

record the project for [Warner]."[3] F. 55. PolyGram responded with an offer of its own: Warner and PolyGram should share financial and operational responsibility, profits, and losses for the 1998 Three Tenors project. F. 56.

For $18 million, Rudas licensed to Warner worldwide audio, video, and home television rights to the 1998 concert ("the 3T3 Rights"). F. 58. Warner sub-licensed to PolyGram the right to exploit the 3T3 Rights outside the United States. F. 59-60. Warner would distribute the new album and video in the United States, and PolyGram was responsible for the rest of the world. The parties also agreed:

- that Warner and PolyGram would each receive 50 percent of the net profits and losses derived from the exploitation of the 3T3 Rights (as well as from the production of a Greatest Hits album and/or a Box Set incorporating the 1990, 1994, and 1998 concerts);

- that PolyGram would reimburse Warner for 50 percent of the $18 million advance paid to Rudas; and

- that other expenses would be shared by Warner and PolyGram on a 50/50 basis.

F. 60.

In negotiating the terms of the 1998 Three Tenors project, PolyGram and Warner and discussed the scope of a covenant not to compete. F. 61. The parties agreed that, for four years, neither would release a new Three Tenors album (except as part of the parties' collaboration). Warner insisted that the non-compete should not apply to the pre-existing Three Tenors albums. F. 62. The final collaboration agreement, dated December 19, 1997, provides that PolyGram and Warner shall each be free separately to exploit its older Three Tenors recordings. F. 62-63.

PolyGram and Warner recognized that the success of the new Three Tenors album was tied to the repertoire, F. 66, and wanted to be sure that the repertoire would be "distinctive," and that it would not repeat selections from the earlier Three Tenors recordings. F. 66. Rudas insisted that he and the artists should control the choice of songs. F. 67-68. PolyGram and Warner agreed. F. 69-72.

During 1998, PolyGram and Warner were concerned that their new Three Tenors album would not be as appealing as the 1990 and 1994 releases. F. 73. Various marketing strategies were considered. F. 74-78. Rudas assured that the album recorded in Paris would be new. F. 79-80. The record companies decided that the all new repertoire would be a key selling point. F. 81. PolyGram

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[3] Pavarotti was under exclusive contract with PolyGram. F. 55. In 1994, PolyGram had waived its exclusive rights, permitting Pavarotti to record 3T2 for Warner. F. 34. Warner was seeking a similar arrangement for 3T3. F. 55.

and Warner agreed that the packaging for 3T3 "must be as different as possible from the two previous releases." F. 78.

C. Moratorium Agreement

At a meeting of PolyGram and Warner representatives in New York in March 1998, PolyGram and Warner agreed not to discount or advertise 3T1 or 3T2 audio and video products in the weeks surrounding the release of the new recording. F. 90-96. They agreed that competition from the older Three Tenors products could reduce the sales and profitability of the new Three Tenors release. F. 268-73.

In April 1998, PolyGram instructed its opcos[4] that, pursuant to an agreement with Warner, aggressive marketing campaigns in support of 3T1 should terminate by the end of July. F. 107. Paul Saintilan (Senior Marketing Director, PolyGram) notified Warner of PolyGram's actions. F. 108-13. Later, PolyGram became concerned that the moratorium would not be implemented by Warner. F. 118-21, 126-27. PolyGram instructed its opcos that if, following the release of 3T3, Warner was discovered discounting 3T2 in a particular market, then the PolyGram opco was free to retaliate by discounting and promoting 3T1. F. 128-29.

D. Repertoire for the 1998 Concert

In mid-June 1998, Rudas informed PolyGram and Warner of the intended repertoire for the upcoming Three Tenors concert. F. 133. The repertoire would include several compositions that were also included on 3T1 and/or 3T2. F. 133-34. PolyGram and Warner expressed to Rudas their dissatisfaction with the intended repertoire. F. 135.

E. Reaffirmance

On June 25, 1998, Anthony O'Brien (Warner) and Paul Saintilan (PolyGram) discussed by telephone their mutual desire to re-enforce the moratorium. F. 137-38. Once again they affirmed that, in the United States, 3T1 and 3T2 would not be discounted or advertised in the weeks following the release of 3T3 (scheduled for August 10, 1998). F. 138. O'Brien assured Saintilan that he would speak with other Warner executives about implementing the moratorium on a worldwide basis as well. F. 139.

On July 2 and July 10, 1998, Saintilan (PolyGram) provided O'Brien (Warner) with letters clarifying the terms of the moratorium, and seeking assurance that Warner would comply in all markets. F. 141-47. O'Brien conferred with executives from Warner's international distribution operation and

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[4] Both PolyGram and Warner distribute their products through a network of affiliated operating companies responsible for sales within a particular country or region. F. 23.

secured their assent to the scheme. F. 148-49. Thereafter, O'Brien notified Saintilan that Warner would adhere to the moratorium on a worldwide basis. F. 150. In mid-July 1998, PolyGram and Warner issued written directives to their respective operating companies instructing that all discounting, advertising, and promotion of 3T1/3T2 was prohibited from August 1, 1998 through October 15, 1998. F. 148-49, 152-53.

F. Intervention of Attorneys

In late July 1998, after the Paris concert but prior to the release of 3T3, lawyers for PolyGram and Warner became involved with the moratorium issue. Paul Saintilan forwarded to PolyGram's General Counsel his documents relating to the Three Tenors moratorium – and then proceeded to "delete" such documents from his files. CX 459. On July 30, 1998, Saintilan wrote to PolyGram operating companies denying an agreement between PolyGram and Warner to restrict competition. F. 156-57.

Attorneys for the two record companies reviewed a draft letter from O'Brien (Warner) to Saintilan (PolyGram) purporting to reject the moratorium agreement for non-U.S. markets. F. 160-62. On August 10, 1998, O'Brien signed the letter and forwarded it to Saintilan. F. 161. Shortly thereafter, O'Brien telephoned Saintilan. O'Brien informed Saintilan that he (O'Brien) had been requested by counsel to send the August 10 letter. O'Brien further informed Saintilan that the Warner still intended fully to comply with the moratorium agreement on a worldwide basis. F. 163. O'Brien's understanding was that PolyGram likewise intended to comply with the moratorium agreement. F. 164.

G. Compliance

Warner and PolyGram complied with the moratorium agreement in the United States. F. 170-75. Between August 1, 1998 and October 15, 1998, neither Warner nor PolyGram discounted its respective catalogue Three Tenors products in the United States. F. 171, 173-74. Between August 1, 1998 and October 15, 1998, neither Warner nor PolyGram funded advertising for 3T1/3T2 in the United States. F. 172.

Both Warner and PolyGram substantially complied with the moratorium agreement outside of the United States as well. F. 177-81.

By memo dated October 26, 1998, Warner notified its operating companies that the moratorium on discounting older Three Tenors products was no longer in effect. CX 463. With the expiration of the moratorium agreement, Warner anticipated that PolyGram would "now discount [3T1] heavily." CX 462.

II. LEGAL DISCUSSION

A. Joint Venture

To encourage new output, the rules for evaluating collaboration by competitors are generally more lenient for joint ventures.[5] Firms may lack capital, labor or technology required to compete effectively in a new business, and case law has favored such collaboration by lowering the antitrust barriers to coordination which plausibly would generate procompetitive benefits.[6] Joint ventures are typically analyzed under the rule of reason.[7] A separate agreement connected to a joint venture will also be evaluated under the rule of reason where the agreement restraining competition is ancillary to the main purpose of the venture and "reasonably adapted and limited to the necessary protection of a party in carrying out of such purpose . . . ." *United States v. Addyston Pipe & Steel Co.,* 85 F. 271, 283 (6th Cir. 1897), *aff'd,* 175 U.S. 211 (1899) (Taft, J.).[8]

B. Ancillary Restraint Doctrine

A joint venture involves contractual undertakings by the parents. Some agreements, such as providing equipment, management, or capital, are central to the joint venture's operation and purpose. Other commitments not intrinsic to the venture may be given to reassure parents that some collateral event harmful to the venture does not occur. If the collateral agreement is necessary to make the joint venture work, and no broader than necessary, it will be ancillary to the venture and must be analyzed under the rule of reason. *In re Brunswick,* 94 F.T.C. at 1275 (citations omitted) described the ancillary doctrine:

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[5] *In re Brunswick Corp.,* 94 F.T.C. 1174, 1265 (1979); *aff'd sub. nom. Yamaha Motor Corp. v. FTC,* 657 F.2d 971 (8th Cir. 1981).

[6] Thomas A. Piraino, Jr., *A Proposed Antitrust Approach to Collaborations Among Competitors,* 86 Iowa L. Rev. 1137, 1139 (2001).

[7] *Id.* Joint ventures have no immunity from the antitrust laws, however. *NCAA v. Bd. of Regents*, 468 U.S. 85, 113 (1984). The rule of reason may involve only a quick look at justifications before condemning a naked restriction on price or output. *Chicago Prof'l. Sports Ltd. Partnership v. NBA,* 961 F.2d 667, 674 (7th Cir. 1992).

[8] Under the ancillary restraint doctrine "some agreements which restrain competition may be valid if they are . . . necessary to make that transaction effective." *Los Angeles Mem'l Coliseum Comm'n v. NFL*, 726 F.2d 1381, 1395 (9th Cir. 1984) (quoting Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* 74 Yale L.J. 775, 797-98 (1965)).

> Certain reductions in competition between the parents are an inevitable consequence of a joint venture agreement. For example, it is to be expected that the joint venturers will put their venture-related business into the venture and "not compete with their progeny." The Supreme Court has recognized that these limited reductions in competition are often necessary to make a joint venture operate efficiently, and therefore may escape the strict application of *per se* rules.
>
> But such agreements, to be legitimately ancillary to a joint venture, must be limited to those inevitably arising out of dealings between partners, or necessary (and of no broader scope than necessary) to make the joint venture work.

To be ancillary to the joint venture, then, a collateral restraint must be an integral part of the venture, or reasonably necessary to make it work. In *Brunswick*, one of the collateral agreements found to violate Section 5 foreclosed Yamaha, one of the joint venturers, from selling its own brand in the United States in competition with the joint venture product. *Id.* at 1276. Yamaha had been buying and reselling outboard motors in the United States under its label, and this business was not included in the assets placed into the joint venture, and was not integral to it. Here, similarly, 3T1 and 3T2 were not placed into the joint venture.

Complaint Counsel argue that the moratorium agreement, to be ancillary, must be essential to the purpose of the joint venture. Respondents argue that it need only be plausibly connected to the venture. *Brunswick* states the law needed to answer this question. To be ancillary, the restriction is "limited to those inevitably arising out of dealings between the partners, or necessary (and of no broader scope than necessary) to make the joint venture work." *Id.* at 1275. In *Polk Bros, Inc. v. Forest City Enters.*, 776 F.2d 185 (7th Cir. 1985), Respondents' strongest case, the restraint was held ancillary because it "may promote the success of" the venture; but the court further held that "[t]he covenant allocating items between the retailers played an important role in inducing the two retailers to cooperate" and Polk "would not have entered into this arrangement . . . unless it had received assurances that [Forest City] would not compete with it. . . . The agreement not to compete was an <u>integral part</u> of the lease and land sale." 776 F.2d at 189-90 (emphasis added). Thus, to be ancillary, the restraint must be an integral part of the venture or reasonably necessary to its promotion.[9]

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[9] Cases in which suspect restraints were upheld involved restraints on products created by, not outside of, the joint venture. *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 23-24 (1979) ("*BMI*") (price restraint affected blanket license that was the product of the joint venture; participants were free to separately license and price their individual works); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 214 (D.C. Cir. 1986) (restrictions concerned ventures' use of joint venture assets); *Polk Bros.,* 776 F.2d at 189-90 (restraint applicable to sales from jointly constructed facility only; ventures remained free to increase output from separately operated facilities). Unlike these cases, the restraint here was not necessary for the creation of the product of the joint venture nor was it a restraint on the product created by the joint venture.

The moratorium agreement was not necessary for the creation of 3T3. The negotiators of the 3T3 joint venture did not have it in their minds while creating the joint venture and in fact specifically agreed that they could continue to exploit 3T1 and 3T2 during the sale of the venture product 3T3. F. 62, 262. The belated moratorium may have been intended to support the introduction of 3T3, but it was created months after the joint venture agreement. F. 263.[10] Further, Warner successfully introduced 3T2 in 1994 in the face of serious competition, with discounts and advertising, by PolyGram's 3T1. F. 200-23. Unless Respondents meet their burden of showing an efficiency justification, the moratorium agreement therefore would not be ancillary to the joint venture.

C. Burden of Proof

Complaint counsel argue that the moratorium agreement is price fixing and reduction in output presumptively anticompetitive, requiring the use of the *per se* or quick look analysis and shifting the burden to respondents to demonstrate a countervailing efficiency sufficient to the overcome the presumption. Complaint counsel further argue that the respondents' proffered efficiency justifications are implausible or invalid. Thus, complaint counsel urges a finding of a violation of Section 5 of the FTC Act.

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[10] Just as in *NCAA*, involving a lawful joint venture to organize college athletic teams, the agreement at issue was not a legitimate ancillary agreement. *NCAA*, 468 U.S. at 113; *see also Law v. NCAA*, 134 F.3d 1010, 1018 n.18 (10th Cir. 1998). In both *NCAA* cases, the restraints may have been supportive of the lawful joint venture but were not integral to it and were broader than necessary to accomplish the purpose. Although *NCAA v. Regent* held the television plan as an unreasonable restraint violating the Sherman Act, the Court could well have found that the plan was supportive of the legitimate joint venture. The television plan there promoted the balance of teams, one of NCAA's essential lawful objectives. *Gen'l Leaseways Inc. v. Nat'l Truck Leasing Ass'n*, 744 F.2d 588, 595 (7th Cir. 1984) (Posner, J.). However, *NCAA* held that the television plan was not a legitimate joint venture agreement because, unlike *BMI*, it did not act as a joint sales agent. The selection of the individual games and the negotiation of particular agreements were left to the networks and the individual schools. The television plan did not eliminate individual sales of broadcasts, since these still occurred, albeit subject to the fixed prices and output limitations, just as in *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982). Similarly, the moratorium agreement here could support the lawful joint venture but still violate Section 5 because it was not integral to the venture nor necessary to market the product. *NCAA*, 468 U.S. at 114. To prove that the moratorium was integral to the venture, Respondents rely on the testimony of Mr. O'Brien that had he known that PolyGram was going to discount 3T1 during the introduction of 3T3 he would not have entered into the joint venture. Tr. at 514-15. The weight of such after the fact reasoning to show intent is generally suspect. *Gen'l Leaseways*, 744 F.2d at 595-96. Since the joint venture agreement specifies that Warner and PolyGram shall be free separately to exploit [e.g., sell at a discount] its older Three Tenors recordings, F. 62-63, this testimony seems to be questionable.

Respondents argue that the moratorium agreement was ancillary to the joint venture, since it plausibly supports the main purpose of the joint venture; that the rule of reason applies to ancillary restraints; that complaint counsel failed to prove competitive injury from the moratorium agreement, relying instead on a presumption of anticompetitive effects from the nature of the agreement; and that the lack of evidence of harmful market effects under the rule of reason requires dismissal of the case.

1. *Per Se* Rule

The moratorium agreement restricted competition in advertising and the price of 3T1 and 3T2, which were not products produced and sold by the joint venture. F.264-67.[11] It was not ancillary to the joint venture and appears to be a naked agreement to fix prices and restrict output. The moratorium agreement could, therefore, be analyzed as a naked agreement[12] violating Section 5 under the *per se* rule.[13]

2. Rule of Reason

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[11] The Warner and PolyGram joint venture agreement did provide that a selection of hits and box products taken from 3T1 and 3T2 might be sold through the joint venture starting in 1999. During the term of the moratorium agreement, August 1 to October 15, 1998, F. 149, the joint venture sold only 3T3. Speculative future joint activity cannot justify a price-fixing agreement in effect during 1998. Herbert Hovenkamp, XI *Antitrust Law* ¶ 1906b at 212 (1998), ("The principle reason for rejecting defenses that a restraint is competitive in the long run is that proof is nearly always highly speculative and the defense could be asserted so often that it would effectively undermine a large proportion of instances properly subject to per se disposition.").

[12] *Law* analyzed the agreement on coaches' salaries under the rule of reason because college sports is an industry where some horizontal agreements among NCAA members are necessary if there is to be a product at all. 134 F.3d at 1019. Respondent did not prove that the music industry requires joint ventures in order to increase output.

[13] Price fixing agreements lack redeeming virtue and are conclusively presumed to be unreasonable. *Nat'l Soc'y of Prof'l Engineers v. United States.*, 435 U.S. 679, 692 (1978) ("*NSPE*"); *Maricopa*, 457 U.S. at 344.

If the case is analyzed under the rule of reason:[14] (1) complaint counsel bears the initial burden of showing that an agreement had a substantially adverse effect on competition; (2) if complaint counsel meets this burden, the burden shifts to respondent to come forward with evidence of procompetitive virtues of the alleged wrongful conduct; and (3) if respondents are able to demonstrate procompetitive effects, complaint counsel then must prove that the challenged conduct is not reasonably necessary to achieve the legitimate objectives or that those objectives can be achieved in a substantially less restrictive manner. Ultimately, if those steps are met, the harms and benefits must be weighed against each other in order to judge whether the challenged behavior is, on balance, reasonable.[15]

Since it was unnecessary and not integral to the joint venture, the moratorium agreement appears to be one that would always or almost always tend to restrict competition and decrease output. *BMI*, 442 U.S. at 19-20. The elimination of competition is apparent on a quick look. A restraint on competition between parents and the joint venture may be a naked agreement, subject to quick look analysis under the rule of reason. *California Dental Ass'n v. FTC*, 526 U.S. 756, 770 (1999) ("*CDA*"); *Law*, 134 F.3d at 1020. If the anticompetitive effects of price fixing are obvious the burden of proceeding switches. *NSPE,* 435 U.S. at 692.[16]

Respondents therefore would have the burden of showing that the procompetitive benefits of the restraint justify the anticompetitive effects. *Law*, 134 F.3d at 1021. Justifications offered under the rule or reason may be considered only to the extent that they tend to show that, on balance, the challenged restraint enhances competition. *NCAA*, 468 U.S. at 104.

D. Competitive Effects

Some restraints almost always tend to raise price or reduce output; the presumptively anticompetitive effect of such an agreement is "intuitively obvious." *CDA*, 526 U.S. at 781; *NCAA*, 468 U.S. at 110. Where anticompetitive effects are presumed, the burden shifts to the respondents to demonstrate a countervailing efficiency sufficient to overcome the presumption. *CDA,* 526 U.S. at 770-71 (1999); *NCAA*, 468 U.S. at 113. This shift occurs in the "abbreviated or 'quick-look' analysis

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[14] Judge Posner felt it was prudent to use both rules in *Gen'l Leaseways,* 744 F.2d at 569, since "it is possible we are wrong in holding this case is governed by the *per se* rule. . . ."

[15] The sequence of shifting of burdens is described in *Law*. 134 F.3d at 1019; *see also United States v. Brown University,* 5 F.3d 658, 669 (3rd Cir. 1993).

[16] A naked, effective restraint on market price or volume can establish anticompetive effect under a truncated rule of reason analysis. *Chicago Prof'l Sports*, 961 F.2d at 674; *see also General Leaseways*, 774 F.2d at 595.

under the rule of reason." *CDA,* 526 U.S. at 770.[17] Where restraints raise obvious potential anticompetitive effects, the merits of the proffered efficiency justifications should be considered in advance of conducting a market analysis. Presumptively anticompetitive restraints may be condemned without assessing market power or examining actual anticompetitive effects. *Id.* at 779; *Brown University,* 5 F.3d at 673. "The absence of proof of market power does not justify a naked restriction on price or output . . . . This naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis." *NCAA,* 468 U.S. at 109-10. The Court rejected the *NCAA's* efficiency justifications, finding that they were plausible but unsupported by the evidence (*i.e.,* invalid).[18]

The issue here, then is whether the agreements between PolyGram and Warner to forgo discounting and advertising fall within a category of restraints that is likely, absent an efficiency justification, to lead to higher prices or reduced output.[19] The assessment of whether a category of

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[17] *See BMI*, 441 U.S. at 30; *NCAA,* 468 U.S. at 110; *F.T.C. v. Indiana Fed'n of Dentists,* 476 U.S. 447, 459 (1986) ("IFD"); *Continental Airlines v. United Airlines*, 277 F.3d 499, 508-510 (4th Cir. 2002)*; Law*, 134 F.3d at 1019-1020; *Brown University*, 5 F.3d at 669; *Chicago Prof'l Sports,* 961 F.2d at 674; *General Leaseways*, 744 F.2d at 595; *In re: Detroit Auto Dealers Assoc.*, 111 F.T.C. 417, 493 (1989)*;In re: Massachusetts Bd. Of Registration in Optometry*, 110 F.T.C. 549, 603-604 (1988).

[18] A naked restraint on price and output is unaccompanied by new production or products; an ancillary restraint is part of a larger endeavor whose success it promotes. *Polk Bros.,* 776 F.2d at 188-89. A naked restraint may be found unlawful even though contained in elaborate joint ventures that were not being challenged and were socially beneficial. For example, while the *NCAA* is a socially beneficial athletic venture involving colleges and universities, both its rule limiting televised football games and the rule fixing maximum coaches salaries were properly characterized by the court as 'naked' restraints on price or output. *NCAA* 468 U.S. at 113-14; *Law*, 134 F.3d at 1018 n.10.

[19] *BMI,* 441 U.S. at 19-20*; IFD*, 476 U.S. at 459; *NCAA*, 468 U.S. at 109-110; *Brown University*, 5 F.3d at 669 (abbreviated antitrust analysis appropriate where "'no elaborate industry analysis is required to demonstrate the anticompetitive character' of an inherently suspect restraint"); *Detroit Auto Dealers Assoc.*, 111 F.T.C. at 498; *Mass. Board*, 110 F.T.C. at 604 ("First, we ask whether the restraint is 'inherently suspect.' In other words, is the practice the kind that appears likely, absent an efficiency justification, to 'restrict competition and decrease output'").

restraints is inherently likely to be anticompetitive should be guided by common sense, legal precedent, and economic theory and research.[20]

1. Agreement on price

The agreement between PolyGram and Warner not to discount 3T1 and 3T2 is price fixing,[21] and subject the abbreviated review.[22] An agreement between competitors to fix minimum prices threatens the efficient functioning of a market economy. *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 639 (1992); *FTC v. Super. Ct. Trial Lawyers Ass'n*, 493 U.S. 411, 435 n.16 (1990) ("*SCTLA*"); *NCAA*, 468 U.S. at 100.

PolyGram and Warner often find it necessary to offer discounts to retailers in order to increase sales levels; this is true of both new releases and older (or catalogue) recordings. F. 239. During 1994, PolyGram responded to the release of 3T2 by aggressively reducing the price of 3T1 in many markets – to the benefit of consumers. F. 214-21. And again in 1998, many PolyGram and Warner operating companies determined that the best way to capitalize upon the public's revived interest in the Three Tenors was by reducing the price of these products (coupled with aggressive advertising campaigns). F. 103-05, 115-18.

An agreement to forgo discounting has an obvious anticompetitive potential. And it is no defense that the competitive injury here was small. That the restrictions were relatively small in scope and is limited in time provides no escape from liability. "A court applying the Rule of Reason asks whether a practice produces net benefits for consumers; it is no answer to say that a loss is 'reasonably small.'" *Chicago Prof'l Sports*, 960 F.2d at 674; *SCTLA,* 493 U.S. at 434-35.

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[20] *See CDA,* 526 U.S. at 781; *NCAA*, 468 U.S. at 103; *Detroit Auto Dealers' Assoc.*, 111 F.T.C. at 496.

[21] F. 235. *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 648 (1980).

[22] *BMI*, 441 U.S. at 1; *NCAA*, 468 U.S. at 100; *NSPE*, 435 U.S. at 692.

2. Agreement on advertising

The agreement between PolyGram and Warner to forgo all advertising is also presumptively anticompetitive.[23] *CDA* expressed a more permissive view toward limited advertising restraints in a professional services market. However, the Court indicated that a complete ban on truthful, non-deceptive advertising – especially in an ordinary commercial market – should continue to be viewed harshly. *CDA*, 526 U.S. at 773.

Antitrust law's hostility to advertising bans is supported by economic theory and empirical research. Information disseminated through advertising serves to educate consumers about the availability of alternatives, quality differences among competing products, sales locations, means of purchase, and pricing. This information assists consumers to find their preferred products at low prices, and thus serves to promote competition. F. 244-45; *see CDA*, 526 U.S. at 773 n.10; *Bates v. State Bar of Arizona*, 433 U.S. 350, 364 (1977).

Advertising restrictions result in consumers paying higher prices. F. 246. Even a short-lived restraint on advertising can have a significant effect on consumers. Dr. Stockum described a study of the New York newspaper strike.[24] In New York, newspapers are important for grocery store advertising. After only a single week without newspapers, supermarket prices increased because of the restriction on advertising. Absent an efficiency justification, Respondents' agreement not to advertise or promote catalogue Three Tenors albums is also likely to be anticompetitive. F. 248.

Advertising has proven to be an important competitive tool in the marketing of Three Tenors products. In 1994, PolyGram used advertising to teach consumers that 3T1, the "original" Three Tenors recording, was still the best performance, still widely available, and indeed often available at a discounted price. F. 210-13, 253. Warner used advertising in its effort to create a distinct identity for 3T2, and to suggest to consumers that the newer release was the superior product. F. 201-09, 254.

During 1998, PolyGram and Warner operating companies wished to offer their older Three Tenors recordings at a discount. Discounting was coupled with an aggressive advertising campaign. F. 103-05, 115-18, 255-58. Warner forecast that by advertising the discount on the wholesale price of 3T2, the company sales could increase by 170 percent. F. 256. Advertising of recorded music can create additional demand, and hence an environment in which discounting by record companies is more likely to occur. F. 259. Upon the release of 3T3 in 1998, PolyGram and Warner aggressively

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[23] *See Blackburn v. Sweeney*, 53 F.3d 825, 827 (7th Cir. 1995); *United States v. Gasoline Retailers Ass'n*, 285 F.2d 688, 691 (7th Cir. 1961); *Federal Prescription Serv., Inc. v. American Pharm. Ass'n*, 484 F. Supp. 1195, 1207 (D.D.C. 1980), *aff'd in part rev'd on other grounds in part,* 663 F.2d 253 (D.C. Cir. 1981); *Massachusetts Bd.*, 110 F.T.C. at 606-608.

[24] F. 246-47; Stockum, Tr. 599-600.

advertised it in every available media. F. 168. The record companies intended that their advertising ban would conceal the availability of better value Three Tenors recordings, and that consumers would instead purchase the higher margin 3T3 release. F. 269. The potential anticompetitive effect of this strategy is obvious.

E. Efficiency Defenses

1. Must be plausible and valid

Since the Three Tenors moratorium involved presumptively anticompetitive restraints, Respondents must demonstrate a plausible and valid efficiency justification. *CDA,* 526 U.S. at 771;

NCAA, 468 U.S. at 113.[25] Respondents must show that the moratorium was necessary in order to promote competition and benefit consumers. *BMI*, 441 U.S. at 23; *NCAA*, 468 U.S. at 114.[26]

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[25] Respondents put into evidence the reports of its experts Dr. Yoram Wind and Dr. Janusz Ordover. Expert reports are not as reliable as expert testimony at trial. *Tokio Marine and Fire Ins. Co. v. Norfolk & Western Rwy. Co.*, 1999 U.S. App. LEXIS 476, *10 (4th Cir. 1999); *Engerbretsen v. Fairchild Aircraft Corp.*, 21 F.3d 721, 729 (6th Cir. 1994). The report is not submitted under oath. There is no basis to evaluate the expert's qualifications or credibility. *EPIS, Inc. v. Fidelity and Guar. Life Ins. Co.,* 156 F. Supp. 2d 1116, 1124 (N.D. Cal. 2001). The witness has not been judicially designated as an expert. The witness has not been subject at trial to cross-examination. *Weil v. Long Island Sav. Bank*, 2001 U.S. Dist. LEXIS 22915, *10-11 (E.D.N.Y 2001).

In preparing his report, Dr. Wind reviewed no documents from the files of Warner or deposition testimony of any individual responsible for marketing 3T3 in the United States; or any Warner employee. F. 327. Dr. Wind discusses whether the moratorium is plausibly pro-competitive, but he does not evaluate whether the restraints were actually necessary to achieve some efficiency in the United States. Wind Dep. (JX 91) at 10-11. Dr. Ordover's report rejects the basic premises of modern antitrust analysis. According to Dr. Ordover, if a restraint is adopted in the context of a non-sham joint venture, then the restraint should be considered to be "reasonably necessary," Ordover Dep. (JX 90) at 50, and analyzed under the full rule of reason. Ordover Dep. (JX 90) at 44 ("I would say that a – a quick look of restraints would be best left for those joint ventures that are a sham."). According to Dr. Ordover, there is no threshold requirement to consider the validity of the efficiency argument, Ordover Dep. (JX 90) at 213, and no need to consider the availability of less restrictive alternatives. Ordover Dep. (JX 90) at 77. This is inconsistent with the antitrust case law governing abbreviated rule of reason, *NCAA*, 469 U.S. 85; *Law*, 134 F.3d 1010; *Chicago Prof'l Sports*, 961 F.2d 667; *General Leaseways*, 744 F.2d 588. Because they are unsupported by live testimony, untested by cross-examination, detached from the evidence adduced in this case, and inconsistent with the case law, the reports of Drs. Wind and Ordover have little evidentiary value.

[26] An efficiency argument is implausible (insufficient on its face) where, for example, it is pretextual, *Eastman Kodak Co. v. Image Technical Servs. Inc.*, 504 U.S. 451, 461 (1992), inapposite to the factual circumstances presented, *Law*, 134 F.3d at 1022, or where the argument is premised upon the claim that competition is unworkable or undesirable. *IFD*, 476 U.S. at 463; *NCAA,* 468 U.S. at 116-7; *NSPE*, 435 U.S. at 696. An efficiency justification should be rejected as invalid where, *inter alia*, it is speculative or unproven, *IFD,* 476 U.S. at 463; *Chicago Prof'l Sports,* 961 F.2d at 674-76, where the argument sweeps too broadly, *IFD*, 476 U.S. at 463; *Catalano*, 446 U.S. at 649-50; *NSPE*, 435 U.S. at 696; *Mass. Board*, 110 F.T.C. at 607-08, where there is a less restrictive alternative, *NCAA*, 468 U.S. at 114; *Maricopa County Med. Soc'y*, 457 U.S. at 351-52; *NSPE*, 435 U.S. at 696; *Chicago Prof'l Sports,* 961 F.2d at 674-76; *Mass. Board*, 110 F.T.C. at

Respondents must demonstrate that the moratorium did in fact promote the efficiency of the PolyGram/Warner collaboration. *In re: Indiana Fed. of Dentists*, 101 F.T.C. 57, 175 (1983), *vacated*, 745 F.2d 1124 (7th Cir. 1984), *rev'd*, 476 U.S. 447 (1986); *CDA*, 526 U.S. at 775 n. 12.[27] Respondents have the burden of showing "empirical evidence of procompetitive effects" in the context of a "quick look" analysis. *CDA*, 526 U.S. at 775 n.12.[28] The case can be resolved on an abbreviated analysis of the proffered efficiency justifications without an examination of market power or actual anticompetitive effects.[29]

The parties' motivation for the moratorium was to shield 3T3 from competition. F. 268-75. But even if the parties harbored a good faith belief that the moratorium was necessary and pro-competitive, this would not establish the validity of any efficiency justification. *NCAA*, 468 U.S. at 101 n.23. Respondents' assertion that the moratorium would assist PolyGram and Warner to recoup their $18 million investment is not a procompetitive (*i.e.*, pro-consumer) justification for the Three Tenors moratorium. *Chicago Prof'l Sports v. NBA*, 754 F. Supp. 1336, 1359 (N.D. Ill. 1991), *aff'd*, 961 F.2d 667 (7th Cir. 1992).[30] It is not a defense under the FTC Act. *SCTLA*, 493 U.S. at 422.

Respondents contend that the Three Tenors moratorium was adopted in response to the risk that certain European operating companies would free ride on the promotional opportunity created by the Paris concert. Respondents cannot justify the agreement to restrain competition in the marketing of Three Tenors products in the United States with the claim that the moratorium was necessary for the efficient marketing of 3T3 in Europe. *Law v. NCAA*, 902 F. Supp. 1394, 1406 (D. Kan. 1995), *aff'd*, 134 F.3d 1010 (10th Cir. 1998); *Sullivan v. National Football League*, 34 F.3d 1091, 1112 (1st Cir. 1994); *RSR Corp. v. FTC*, 602 F.2d 1317, 1325 (9th Cir. 1979).

607-08, or where the restraint is not an effective remedy for the competitive problem that it purports to address. *NCAA*, 468 at 116, 119; *Law*, 134 F.3d at 1022-24.

[27] *See also* Timothy J. Muris, *The Federal Trade Commission and the Rule of Reason: In Defense of Massachusetts Board*, 66 Antitrust L.J. 773, 778-79 (1998) ("Compared to the plausibility stage inquiry, the court must delve more deeply into the factual assertions of the parties to determine whether (1) the claimed efficiency benefits are real, and (2) the restraint is reasonably necessary to achieve them. If a proffered explanation fails on either count, then the court should declare the challenged restraint unlawful under the abbreviated rule of reason.").

[28] *CDA,* 526 U.S. at 779-81.

[29] *Continental Airlines*, 277 F.3d at 508.

[30] *See also Law*, 134 F.3d at 1023; *Delaware & Hudson Ry. Co. v. Consolidated Rail Corp.*, 902 F.2d 174, 178 (2d Cir. 1990).

2. The moratorium must be necessary

In December 1997/January 1998, Polygram and Warner agreed to pay $18 million to Rudas in exchange for the right to distribute audio and video recordings of the next Three Tenors concert. F. 58-59. The parties first agreed to the moratorium later, in March 1998. F. 92-94. The later moratorium agreement cannot be deemed necessary for the earlier agreement to collaborate. F. 263.

Respondents stipulate that the Three Tenors' moratorium was not necessary to the formation of the joint venture between PolyGram and Warner. F. 262. It also was not necessary for the production of the Paris concert, for the creation of 3T3, or to assure the distribution of 3T3 in the United States. PolyGram and Warner were committed to these activities well before discussions of the moratorium even commenced. F. 263-64. The challenged restraints were not necessary to procure any of the activities.[31]

3. Free-riding

Respondents argue that without the moratorium agreement, promotional investments by PolyGram and Warner intended to benefit sales of 3T3 in Europe may instead have led some consumers in Europe to purchase at a lower price 3T1 (distributed by PolyGram) or 3T2 (distributed by Warner).[32] To be sufficient to justify an agreement to fix prices and forgo all advertising in the United States, Respondents must show that: (i) absent the challenged restraints, free-riding is likely to have the effect of eliminating some valued service from the marketplace; (ii) there was no reasonable means by which the competitor that benefits from the valued service (the alleged free rider) could have compensated the firm that was providing such service; and (iii) there were no less restrictive alternatives. *Toys "R" Us, Inc.,* 126 F.T.C. 415, 600-07 (1998) ("*TRU*"), *aff'd*, 221 F.3d 928 (7th Cir. 2000).

It is common for advertising to benefit a competitor different from the firm that funded the advertising. CX 612 (Stockum Rebuttal Report) at ¶ 17. The prospect of free-riding does not,

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[31] *Blackburn*, 53 F.3d at 828 (allocation of territories was not ancillary to agreement to dissolve law partnership where restraint was adopted after the termination of the partnership); *Polk Bros.,* 776 F.2d at 189.

[32] Respondents' Trial Brief at 13.

however, lead sellers of consumer products to abandon all advertising.[33] Instead, sellers generally respond to this challenge by using advertising to create a distinct identity for the target product.[34]

Within the recorded music industry, free-riding is commonplace. Advertising intended to benefit one album often leads to sales of competing albums. F. 280.[35] Warner introduced 3T2 during 1994. Warner anticipated competition from PolyGram (3T1). F. 200, 202. But Warner did not forgo all advertising (and Warner did not seek a moratorium with its rival). F. 200-09. Instead, Warner devised an aggressive marketing campaign aimed at distinguishing 3T2 and convincing consumers that 3T2 was preferable to 3T1. F. 203. Warner's marketing campaign for 3T2 was a success; the project was profitable; and four years later Warner was anxious to acquire distribution rights to 3T3 – initially without the participation of PolyGram. F. 52, 222-23.

Advertising for one product often will benefit rival products, however more than just lost sales is required in order to justify a resort to price fixing – or else price-fixing agreements would be the rule rather than the exception. Herbet Hovenkamp, XII *Antitrust Law* ¶ 2032b at 184 (1999) ("free-riding is ubiquitous in our society"). Respondents must show a danger that, because of free-riding and absent a restraint, advertising for 3T3 would have disappeared or have been substantially curtailed.

The evidence on this issue does not support Respondents' free-riding defense. Witnesses representing both Warner and PolyGram testified that 3T3 would have been aggressively and appropriately promoted without the moratorium, and indeed that the moratorium had no significant effect on the resources devoted to advertising and promoting 3T3. O'Brien, Tr. 448, 490; Saintilan Dep. (JX 94) at 88-89, 194-195. In June 1998, when it appeared to PolyGram that the Three Tenors moratorium would fall apart, PolyGram did not alter its marketing strategy or cut back on its advertising budget. PolyGram's only response was to notify its operating companies that if Warner were found selling 3T2 at discounted prices in any territory, then the local PolyGram operating company could respond by discounting 3T1. F. 129-30.[36]

If there were a serious free-riding problem in connection with the marketing of 3T3, the problem existed in Europe but not the United States. Ordover Dep. (JX 90) at 36-37. Dr. Ordover calculated that the magnitude of sales diverted from 3T3 to 3T1 in the United States due to free-riding during the moratorium period (August - October 1998) would have been small (sales of less than

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[33] Wind Dep. (JX 91) at 128-29.

[34] Ordover Dep. (JX 90) at 199; CX 612 (Stockum Rebuttal Expert Report) at ¶ 17.

[35] Cloeckaert Dep. (JX 97) at 46; F. 281; RX 716 (Ordover Expert Report) at ¶ 36; Ordover Dep. (JX 90) at 130.

[36] Saintilan Dep. (JX 94) at 82.

$86,000 per month). F. 294. Dr. Ordover was unable to conclude that free-riding in the United States would have had a significant impact on the venturers' incentives to advertise 3T3. Ordover Dep. (JX 90) at 158-59.

The Three Tenors moratorium agreement was not necessary to preserve incentives to advertise and promote 3T3 in the United States. Respondents' free-riding defense therefore fails. *See TRU*, 126 F.T.C. at 605.

Even assuming that there was a legitimate concern with free-riding here, there is also a solution: joint advertising arrangements. Where firms that share the benefits from advertising also share of the costs of such advertising, any free-riding problem is remedied. *TRU*, 126 F.T.C. at 602.

PolyGram and Warner decided to share the cost of promoting 3T3 in the United States, on a 50/50 basis. O'Brien, Tr. 419-20.[37] The ability of PolyGram and Warner to compensate one another for the value of the 3T3 advertising defeats the free-riding defense. *Chicago Prof'l Sports,* 961 F.2d at 675, and *General Leaseways*, 744 F.2d at 592.[38]

Respondents contend that whereas PolyGram and Warner allocate the costs of advertising on a 50/50 basis, the division of benefits from 3T3 advertising may not be precisely equal. It is not important that compensation from one competitor to the other be exactly the right amount. It is sufficient that the cost-sharing mechanism "ensure[s] the continuation of the beneficial activity." *TRU*, 126 F.T.C. at 602.

Warner and PolyGram agreed to share the cost of advertising and promoting 3T3 upon terms satisfactory to them. This limited form of cooperation eliminates the free-riding problem and obviates

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[37] The license agreement between Warner and PolyGram provides that the two music companies shall each be entitled to 50 percent of the net profits and net losses derived from sales of 3T3 worldwide. Any advertising or marketing expenses incurred by either party are to be deducted from revenues for purposes of calculating net profits (losses). Given the financial structure of the venture, every dollar spent in the United States by Warner to promote 3T3 is partially reimbursed by PolyGram; fifty cents comes from each of the venturers. F. 301.

[38] *See also High Tech. Careers v. San Jose Mercury News*, 996 F.2d 987, 992 (9th Cir. 1993); *United States v. Microsoft Corp.,* 1998-2 Trade Cas. (CCH) ¶ 72, 261 at 82,682 (D.D.C. 1998); *TRU, Inc.,* 126 F.T.C. at 601.

the need for the parties to engage in price-fixing or to adopt an advertising ban. F. 300-05. The scope of the moratorium could also have been limited to Europe. F. 306.[39]

In addition, any danger that advertising for 3T3 may have benefitted the older Three Tenors albums arose principally because 3T3 was not sufficiently different from 3T1 and 3T2. RX 617 (Ordover Expert Report) ¶¶ 16, 31. In 1994, Warner used the tools of marketing (*e.g.,* packaging, advertising) to create a unique identity for 3T2, distinct from 3T1. F. 203-08. A similar strategy could have been pursued for 3T3 in 1998.[40]

4. Consumer confusion

Respondents argue that the moratorium helped eliminate the risk that some consumers would confuse the various Three Tenors albums and not purchase the new album that they intended to buy. Analogous challenges to consumer sovereignty were dismissed in *IFD* and *NSPE*, as "nothing less than a frontal assault on the basic policy of the Sherman Act."[41]

There is no evidence that consumers were confused in selecting among the various Three Tenors albums – only that PolyGram marketing manager Paul Saintilan was "concerned" that confusion may arise. F. 312-13. This feeling was not based upon research, data, or observation. F. 312. It does not justify restraints on competitive activity.[42]

Confusion identified by Respondents could have been remedied though measures less restrictive than the moratorium. If the cover art for 3T3 resembled the cover art for 3T1 and 3T2, packaging for 3T3 could be made more distinct. F. 314. Music retailers have the incentive and ability

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[39] There is no evidence that, during the moratorium period, discounted copies of 3T1 and 3T2 would have been transshipped from the United States to Europe. Nor is there evidence that such transshipment would disrupt the marketing of 3T3 in the United States or anywhere else. F. 307-08.

[40] *See* JX 106 (Moore Rebuttal Expert Report) ¶¶ 5-11; Moore, Tr. 123-35; Ordover Dep. (JX 90) at 144.

[41] *IFD*, 476 U.S. at 463 (rejecting claim that providing x-rays to insurance companies will necessarily lead them to make unwise and dangerous choices); *NSPE,* 435 U.S. at 694 (rejecting claim that competitive bidding will necessarily lead to inferior engineering work).

[42] Absent the moratorium, discounting of 3T1 and 3T2 could have helped to differentiate these products from the new Three Tenors release. F. 318. Advertising campaigns on behalf of 3T1 and 3T2 could have emphasized the distinctive features of these albums (as was done in 1994). F. 317. The competitive activity squelched by the moratorium should dispel rather than foster consumer confusion. *Cf. Law*, 134 F.3d at 1024.

to display their products in a manner that would not confuse their customers. F. 319-20. Warner could have worked with music retailers to ensure that 3T3 was displayed in a manner that consumers would not find confusing. F. 321-22.

To cure consumer confusion, a seller is not permitted to make its product appear unique by inducing a competitor to withdraw its competing products.[43] Confusing competition is preferred to the clarity offered by collusion.[44]

The suppression of 3T1 and 3T2 was not necessary to the effective marketing of 3T3. In 1994, Warner marketed 3T2 effectively and successfully without suppressing 3T1. In 2000, Sony released the fourth Three Tenors album, consisting principally of Christmas songs. Sony marketed its Three Tenors album without seeking a moratorium on the marketing of previous Three Tenors albums. F. 197-99.

The real issue is not that consumers are confused by multiple Three Tenors products. Consumers are discerning. Given a choice between 3T3 and one of the older Three Tenors albums, some consumers may view a discounted 3T1 or 3T2 as the better value. F. 268-69. The safest way for PolyGram and Warner to maximize their profits on 3T3 was, therefore, to agree to maintain high prices on the older Three Tenors recordings.

That 3T3 was (in the eyes of the record companies and perhaps consumers) a disappointing product cannot justify an effort by the venturers to insulate this product from competition. F. 324. A similar argument was rejected in *NCAA*. The NCAA joint venture argued that a restriction on the telecast of college football games was necessary in order to protect live attendance at games. Such a strategy, the Supreme Court explained, would diminish rather than enhance consumer welfare: "By seeking to insulate live ticket sales from the full spectrum of competition because of its assumption that the product itself is insufficiently attractive to consumers, petitioner forwards a justification that is inconsistent with the basic policy of the Sherman Act." *NCAA*, 468 U.S. at 116-117.

5. The moratorium as product promotion

Respondents argue that if the moratorium agreement succeeded in generating early sales of 3T3, such sales would garner publicity for this new product. Hoffman, Tr. 360. The *Brown University* case rejected that claim that a price restraint may benefit consumers by channeling resources into efforts to improve quality. "This is not the kind of pro-competitive virtue contemplated under the [Sherman] Act, but rather one mere consequence of limiting price competition." 5 F.3d at

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[43] *NCAA,* 468 U.S. at 116-17.

[44] *United States v. Western Electric Co.*, 583 F. Supp. 1257, 1260 (D.D.C. 1984).

675. In the same way, suppressing promotion of 3T1 and 3T2 may by default lead consumers to pay greater attention to 3T3, but this is not a pro-competitive benefit.[45]

The moratorium agreement was not a necessary strategy for publicizing 3T3. Warner had many less restrictive alternative methods of generating attention for 3T3. F. 168. In lieu of raising the price of 3T1 and 3T2, Respondents could have reduced the price of 3T3. F. 169.

F. Respondents' Withdrawal From the Moratorium

In the United States during the moratorium period (August 1 to October 15, 1998), there was no significant discounting or advertising of 3T1 by PolyGram; and during the moratorium period, there was no significant discounting or advertising of 3T2 by Warner. F. 170-76. Respondents assert, however that PolyGram withdrew from the moratorium agreement, that PolyGram did not implement the agreement, and that neither PolyGram nor Warner would have discounted or advertised 3T1/3T2 regardless of any agreement.

Withdrawal from an unlawful agreement does not erase the underlying violation. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940).[46] The government is not required to prove any overt acts in furtherance of the alleged conspiracy.[47] An accepted invitation is not immune from liability under Section 5.[48]

Paul Saintilan testified at deposition that in July 1998 he informed Warner executive Anthony O'Brien that PolyGram would not implement the moratorium. But O'Brien credibly testified at trial and

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[45] *See also NCAA*, 468 U.S. at 116-117 (increased ticket sales is not a legitimate justification for limitations on telecasts of college football); *Catalano*, 446 U.S. at 649.

[46] *See also United States v. Hayter Oil Co.*, 51 F.3d 1265, 1270-71 (6th Cir. 1995); *United States v. Mobile Materials, Inc.*, 871 F.2d 902, 908 (10th Cir. 1989) (per curiam), *modified per curiam*, 881 F.2d 866 (10th Cir. 1989); *Konik v. Champlain Valley Physicians Hosp. Med. Ctr.,* 733 F.2d 1007, 1019 (2d Cir. 1984).

[47] *Summit Health, Ltd. v. Pinhas*, 500 U.S. 322, 330 (1991); *Nash v. United States*, 229 U.S. 373, 378 (1913) (Holmes, J.) (Sherman Act "does not make the doing of any act other than the act of conspiring a condition of liability"); *Mobile Materials, Inc.*, 871 F.2d at 908; *United States v. Miller*, 771 F.2d 1219, 1226 (9th Cir. 1985); *United States v. Portsmouth Paving Corp.*, 694 F.2d 312, 324 (4th Cir. 1982).

[48] Even an unaccepted invitation to collude may raise antitrust liability. *United States v. American Airlines*, 743 F.2d 1114, 1121 (5th Cir. 1984).

denied that such conversation ever occurred. No PolyGram representative ever told O'Brien that PolyGram intended to withdraw from its agreement not to compete. O'Brien, Tr. 473.

The documentary record supports O'Brien. In July 1998, in an effort to conceal his actions, Saintilan destroyed documents regarding the moratorium, but he had no incentive to destroy exculpatory materials. JX 76 at UMG000213. It is most likely then that the conversation described by Saintilan never took place.

Warner and PolyGram attorneys exchanged draft versions of what later became the August 10 letter from O'Brien to Saintilan (purporting to reject the moratorium proposed by PolyGram). F. 160-62. These communications cannot constitute PolyGram's effective withdrawal from the conspiracy. The August 10 letter describes Warner's intended conduct in Europe, not PolyGram's, and the August 10 letter was countermanded by O'Brien. F. 160-63.

Warner perceived and understood that PolyGram was in fact complying with the moratorium on a worldwide basis between August 1 and October 15, 1998. F. 170, 173-74, 177-81. PolyGram's supposed "withdrawal" was not communicated to Warner: only after October 15 did Warner promote 3T2; and only after October 15 did Warner anticipate that PolyGram would discount 3T1. F. 182. Little weight can be accorded to deposition testimony that conflicts with the contemporaneous written record.[49]

CONCLUSIONS OF LAW

I. The Federal Trade Commission has jurisdiction over the subject matter of this proceeding, and over Respondents PolyGram Holding, Inc., Decca Music Group Limited, UMG Recordings, Inc., and Universal Music & Video Distribution Corp. (collectively, "PolyGram" or "Respondents").

II. At all relevant times, each respondent was a corporation within the meaning of Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

III. Respondents' acts and practices, including the challenged acts and practices, are in or affect commerce as "commerce" is defined in the Federal Trade Commission Act, 15 U.S.C. § 44.

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[49] *United States v. United States Gypsum Co.*, 333 U.S. 364, 396 (1947); *Millar v. FCC*, 707 F.2d 1530, 1541 (D.C. Cir. 1983); *Gainesville Utils. Dep't v. Florida Power & Light Co.*, 573 F.2d 292, 301 n.14 (5th Cir. 1978); *Pension Benefit Guar. Corp. v. Envirodyne Industries, Inc.*, 1988 U.S. Dist. LEXIS 16044 *2-3 (N.D. Ill. 1988).

IV. Respondents have entered into contracts, combinations, or conspiracies with their competitor, Warner Music Group ("Warner"), constituting unfair methods of competition, in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

V. In 1998, PolyGram and Warner agreed to observe a "moratorium" on competitive activity. The parties agreed to forgo discounting and advertising of older Three Tenors audio and video products (referred to as "3T1" and "3T2") for a period of time following the release of a new Three Tenors recording (referred to as "3T3").

VI. Certain categories of restraints almost always tend to raise price or reduce output, and hence are presumptively anticompetitive.

VII. The moratorium agreement between PolyGram and Warner to forgo discounting and advertising is likely, absent an efficiency justification, to lead to higher prices or reduced output, and hence is presumptively anticompetitive.

VIII. Where a presumptively anticompetitive agreement is proven, the burden shifts to the Respondents to prove the existence of a plausible and valid efficiency justification for the restraint. That is, Respondents must show that the moratorium was necessary in order to promote competition and benefit consumers.

IX. Where a presumptively anticompetitive restraint is ancillary to a collaboration, Respondents must show that the restraint is necessary in order to achieve the pro-competitive benefits of that collaboration.

X. An agreement entered into following the formation of a joint venture to forgo discounting and advertising for the pre-existing, separately produced, and separately distributed products of the individual venturers is not ancillary to the joint venture agreement. The price restraint is *per se* illegal.

XI. Where the proffered efficiency justifications are either implausible on their face or invalid in view of the relevant facts, the presumptively anticompetitive restraint can be condemned, without assessing market power or examining actual anticompetitive effects.

XII. An efficiency argument is implausible (insufficient on its face) where, for example, it is pretextual, inapposite to the factual circumstances presented, or where the argument is premised upon the claim that competition is unworkable or undesirable.

XIII. An efficiency justification should be rejected as invalid where, for example, it is speculative or unproven, where the argument sweeps too broadly, where there is a less restrictive alternative, or where the restraint is not an effective remedy for the competitive problem that it purports to address.

XIV. Respondents have not met their burden of identifying a plausible efficiency justification for the challenged restraints. Respondents' claim that the moratorium agreement addresses a market failure in Europe can not justify the agreement to restrain competition in the United States.

XV. Even if the justifications proffered by Respondents were deemed plausible, Respondents have not met their burden of proving the existence of a valid efficiency justification.

XVI. In order to demonstrate a valid free-riding defense, Respondents must show that: (i) absent the challenged restraints, free-riding was likely to have the effect of eliminating some valued service from the marketplace; (ii) there was no reasonable means by which the competitor that benefitted from the valued service (the alleged free rider) could have compensated the firm that was providing such service; and (iii) there were no less restrictive alternatives. Respondents have satisfied none of these requirements.

XVII. In the recorded music industry, it is common for advertising and other promotional activity to benefit a competitor different from (and in addition to) the firm that funded the advertising. Generally, this does not lead record companies to abandon or even significantly to curtail advertising. The evidence does not support a finding that the venturers' advertising expenditures in support of 3T3 would have significantly decreased in the United States without the moratorium agreement.

XVIII. Where firms that share the benefits from advertising also share the costs of such advertising, free-rider problems are reduced or eliminated. Even assuming that there was a potential free-riding problem in connection with advertising for 3T3, PolyGram and Warner effectively remedied the free-riding problem by sharing the costs of advertising 3T3.

XIX. Other substantially less restrictive alternatives for addressing the purported free-riding concern were also available to PolyGram and Warner. For example, Respondents could have limited the moratorium to Europe (the site of the alleged free-riding problem).

XX. The Three Tenors moratorium agreement was not necessary to eliminate consumer confusion. The evidence does not support a finding that consumers were actually confused in selecting among the various Three Tenors products. Further, the potential for confusion could have been remedied by making the packaging for 3T3 more distinct, and/or by working with retailers to ensure that the Three Tenors products were displayed in a manner that consumers would not find confusing.

XXI. The claim that suppressing promotion of similar, competing products is necessary in order to eliminate confusion conflicts with the basic policy of the antitrust laws.

XXII. The Three Tenors moratorium agreement was not necessary for the formation of the 3T3 collaboration between Warner and PolyGram.

XXIII. The Three Tenors moratorium agreement was not necessary for the effective marketing of 3T3 in the United States.

XXIV. Modest cost savings may be achieved by any joint selling arrangement; this however is not a sufficient justification for the adoption of presumptively anticompetitive restraints.

XXV. When a firm withdraws from the market at the behest of a rival, this will enable the surviving competitor to generate additional consumer attention, publicity, and sales. These effects may be the by-product of any market division agreement, and are not a cognizable antitrust defense.

XXVI. Section 5 of the FTC Act proscribes anticompetitive agreements. Respondents' claim that the moratorium agreement was not implemented in the United States is not supported by the evidence, and is not a valid antitrust defense.

XXVII. Respondents' claim that they withdrew from the moratorium agreement is not supported by the evidence, and is not a valid antitrust defense.

XXVIII. The acts or practices of Respondents were and are to the prejudice and injury of the public. The acts or practices constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. These acts may recur in the absence of the Order entered in this proceeding.

XXIX. Entry of the Order is in the public interest, and is necessary to protect the public now and in the future.

CEASE AND DESIST ORDER

"[O]nce the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor." *United States. v. E.I. du Pont De Nemours and Co.*, 366 U.S. 316, 334 (1961). "The Commission has wide discretion in its choice of a remedy deemed adequate to cope with the unlawful practices" so long as the remedy has a "reasonable relation to the unlawful practices found to exist. *Jacob Siegel v FTC*, 327 U.S. 608, 611-13 (1946). Further, "the Commission is not limited to prohibiting the illegal practice in the precise form in which it is found to have existed in the past. . . . [I]t must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity." *FTC v. Ruberoid Co.,* 343 U.S. 470, 473 (1952).

The Commission may issue an order even where the respondent has discontinued the illegal practice, where the possibility of a recurrence of the illegal activity exists.[50] Where, as here, the respondents have refused to acknowledge their past lawlessness, this may be viewed as evidence that the illegal activity may recur. *Wilk*, 895 F.2d at 366.

The marketing challenge that gave rise to the Three Tenors moratorium may recur: the fear that a new release by a given artist may lose sales to the artist's older albums. Respondents have recording contracts with several artists that formerly released albums with one of Respondents' competitors. F. 331-32.[51] Universal is engaged in other joint ventures where a similar incentive and opportunity to restrain competition is presented. Universal and Sony have formed a joint venture known as "Pressplay" to distribute music over the Internet. Universal, Sony, and other music companies will provide their music to the venture on a non-exclusive basis. This means that music products marketed by the venture may also be marketed (*e.g.,* by Sony) through traditional retail outlets. Absent an order, Universal and Sony may find it profitable to fix prices on products sold to retail stores in order to enhance the venture's internet sales and profits. F.334.

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[50] *See United States v. Oregon State Med. Soc'y.*, 343 U.S. 326, 333 (1952); *Wilk v. American Med. Assoc*., 895 F.2d 352, 366-68 (7th Cir. 1990); *Official Airline Guides, Inc. v. FTC,* 630 F2d. 920, 928 (2d Cir. 1980); *see also*, *Marlene's, Inc. v. FTC*, 216 F.2d 556, 560 (7th Cir. 1954).

[51] A music label may release an artist from his exclusive recording contract in return for a royalty on the artist's first album on his new label. When this occurs, the two competing labels may have a shared financial interest in the success of a particular album. Hoffman, Tr. 357.

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

In the Matter of POLYGRAM HOLDING, INC., a corporation, DECCA MUSIC GROUP LIMITED, a corporation, UMG RECORDINGS, INC., a corporation, and UNIVERSAL MUSIC & VIDEO DISTRIBUTION CORP., a corporation.	Docket No. 9298

ORDER

I.

1: "PolyGram Holding" means PolyGram Holding, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by PolyGram Holding, Inc.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

2: "Decca Music" means Decca Music Group Limited, its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Decca Music Group Limited; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

3: "UMG" means UMG Recordings, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by

UMG Recordings, Inc.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

4: "UMVD" means Universal Music & Video Distribution Corp., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Universal Music & Video Distribution Corp.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

5: "Respondents" means PolyGram Holding, Decca Music, UMG, and UMVD, individually and collectively.

6: "Commission" means the Federal Trade Commission.

7: "Audio Product" means any prerecorded music in any physical, electronic, or other form or format, now or hereafter known, including, but not limited to, any compact disc, magnetic recording tape, audio DVD, audio cassette, album, audiotape, digital audio tape, phonograph record, electronic recording, or digital audio file (*i.e.,* digital files delivered to the consumer electronically to be stored on the consumer's hard drive or other storage device).

8: "Video Product" means any prerecorded visual or audiovisual product in any physical, electronic, or other form or format, now or hereafter known, including, but not limited to, any videocassette, videotape, videogram, videodisc, compact disc, electronic recording, or digital video file (*i.e.,* digital files delivered to the consumer electronically to be stored on the consumer's hard drive or other storage device).

9: "Seller" means any Person other than a Respondent that produces or sells at wholesale any Audio Product or Video Product.

10: "Joint Venture Agreement" means a written agreement between a Respondent and a Seller that provides that the parties to the agreement shall collaborate in the production or distribution (including, without limitation, through the licensing of intellectual property) of Audio Products or Video Products.

11: An Audio Product or Video Product is "Jointly Produced" by a Respondent and a Seller when, pursuant to a written agreement between such Respondent and such Seller, each contributes significant assets to the production or distribution of the Audio Product or Video Product (including, without limitation, personal artistic services, intellectual property, technology, manufacturing facilities, or distribution networks) to achieve procompetitive benefits. For example and without limitation, an Audio Product or Video Product is "Jointly Produced" by a Respondent and a Seller when (1) such product is manufactured or packaged by such Seller and sold at wholesale by such Respondent, or (2) such product is manufactured or packaged by such Respondent and sold at wholesale by such Seller.

12: “Person” means both natural persons and artificial persons, including, but not limited to, corporations, partnerships, and unincorporated entities.

13: “Officer, Director, or Employee” means any officer or director or management employee of any Respondent with responsibility for the pricing, marketing, or sale in the United States of Audio Products or Video Products.

14: “United States” means the fifty states, the District of Columbia, the Commonwealth of Puerto Rico, and all territories, dependencies, and possessions of the United States of America.

II.

IT IS ORDERED that Respondents shall cease and desist from, directly, indirectly, or through any corporate or other device, in or affecting commerce, as “commerce” is defined in the Federal Trade Commission Act, soliciting, participating in, entering into, attempting to enter into, implementing, attempting to implement, continuing, attempting to continue, or otherwise facilitating or attempting to facilitate any combination, conspiracy, or agreement, either express or implied, with any Seller:

A. to fix, raise, or stabilize prices or price levels, in connection with the sale in or into the United States of any Audio Product or any Video Product; or

B. that prohibits, restricts, regulates, or otherwise places any limitation on any truthful, non-deceptive advertising or promotion in the United States for any Audio Product or any Video Product.

III.

IT IS FURTHER ORDERED that:

A. It shall not, of itself, constitute a violation of Paragraph II.A. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement to set the prices or price levels for any Audio Product or Video Product when such written agreement is reasonably related to a lawful Joint Venture Agreement and reasonably necessary to achieve its procompetitive benefits.

B. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement that regulates or restricts the advertising or promotion for any Audio Product or Video Product where such written agreement is reasonably related to a lawful Joint Venture Agreement and reasonably necessary to achieve its procompetitive benefits.

C. It shall not, of itself, constitute a violation of Paragraph II.A. of this Order for a Respondent and a Seller to enter into, attempt to enter into, or comply with a written agreement

to set the prices or price levels for any Audio Product or Video Product that is Jointly Produced by such Respondent and such Seller.

D. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent and a Seller to enter into, attempt to enter into, or comply with a written agreement that regulates or restricts the advertising or promotion for any Audio Product or Video Product that is Jointly Produced by such Respondent and such Seller.

E. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement, industry code, or industry ethical standard that is: (1) intended to prevent or discourage the advertising, marketing, promotion, or sale to children of Audio Products or Video Products labeled or rated with a parental advisory or cautionary statement as to content, and (2) reasonably tailored to such objective.

F. In any action by the Commission alleging violations of this Order, each Respondent shall bear the burden of proof in demonstrating that its conduct satisfies the conditions of Paragraph(s) III.A., III.B., III.C, and III.D. of this Order.

IV.

IT IS FURTHER ORDERED that:

A. Within sixty (60) days after the date this Order becomes final, each Respondent shall submit to the Commission a verified written report setting forth in detail the manner and form in which the Respondent has complied and is complying with this Order.

B. One (1) year after the date this Order becomes final, annually for the next nine (9) years on the anniversary of the date this Order becomes final, and at other times as the Commission may require, each Respondent shall file with the Commission a verified written report:

1. setting forth in detail the manner and form in which it has complied and is complying with this Order; and

2. identifying the title, date, parties, term, and subject matter of each agreement between any Respondent and any Seller, entered into or amended on or after the date this Order becomes final, that: (a) fixes, raises, or stabilizes prices or price levels in connection with the sale in or into the United States of any Audio Product or Video Product, or (b) prohibits, restricts, regulates, or otherwise places any limitation on any truthful, non-deceptive advertising or promotion in the United States for any Audio Product or any Video Product (other than those Audio Products and Video Products that are Jointly Produced).

PROVIDED HOWEVER that Respondents shall not be required to identify in their reports to the Commission any agreement that: (i) was previously identified to the Commission pursuant to Paragraph IV.B.2., and (ii) was not amended following such previous identification.

C. Each Respondent shall retain copies of all written agreements identified pursuant to Paragraph IV.B.2. above; and shall file with the Commission, within ten (10) days' notice to the Respondent, any such written agreements as the Commission may require.

V.

IT IS FURTHER ORDERED that each Respondent shall notify the Commission at least thirty (30) days prior to any proposed change in the Respondent such as dissolution, assignment, sale resulting in the emergence of a successor corporation, or the creation or dissolution of subsidiaries or any other change in the corporation that may affect compliance obligations arising out of the Order.

VI.

IT IS FURTHER ORDERED that, for the purpose of determining or securing compliance with this Order, upon written request, each Respondent shall permit any duly authorized representative of the Commission:

A. Access, during office hours and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and other records and documents in the possession or under the control of the Respondent relating to any matters contained in this Order; and

B. Upon five (5) days' notice to the Respondent and without restraint or interference from it, to interview officers, directors, or employees of the Respondent.

VII.

IT IS FURTHER ORDERED that each Respondent shall:

A. Within thirty (30) days after the date on which this Order becomes final, send a copy of this Order by first class mail to each of its Officers, Directors, and Employees;

B. Mail a copy of this Order by first class mail to each person who becomes an Officer, Director, or Employee, no later than (30) days after the commencement of such person's employment or affiliation with the Respondent; and

C. Require each Officer, Director, or Employee to sign and submit to the Respondent within thirty (30) days of the receipt thereof a statement that: (1) acknowledges receipt of the Order; (2) represents that the undersigned has read and understands the Order; and (3) acknowledges that the undersigned has been advised and understands that non-compliance with the Order may subject the Respondent to penalties for violation of the Order.

VIII.

IT IS FURTHER ORDERED that this Order shall terminate twenty (20) years after the date on which the Order becomes final.

____
James P. Timony
Administrative Law Judge

DATED: June 20, 2002