



**Written Testimony of Luke Froeb before the House
Subcommittee on Courts and Competition Policy on the
Ticketmaster/Live Nation Proposed Merger, 26 February 2009**

Mr. Chairman, Ranking Member Coble, Members of the Subcommittee - thank you for the opportunity to testify before you today. My name is Luke M. Froeb. I am the William Oehmig Associate Professor of Management at Vanderbilt University. I was a staff economist at the Antitrust Division of the U.S. Department of Justice from 1985 to 1992 before moving to Vanderbilt in 1993. In 1989, I spent a year as the Kramer Foundation Fellow at the University of Chicago Law School, and in July 2005, I completed a two-year term as Director of the Bureau of Economics at the U.S. Federal Trade Commission where I managed 75 PhD economists who provided analyses to support enforcement of the U.S. antitrust and consumer protection laws.

To evaluate the competitive effects of mergers, the antitrust enforcement agencies ask two questions: (i) how do the merging parties compete?, and (ii) how does the proposed merger change competition? To answer these questions, agency economists and attorneys engage in a fact-intensive investigation utilizing their powers of subpoena to gather evidence from interviews, documents, and data. They collect evidence from the merging parties, their customers, competitors, and suppliers. They read industry reports and academic studies, conduct financial analyses, examine natural “experiments,” and estimate econometric models.

In sum, the agencies have better information, more resources, and more time to dig deeply into the issues of concern in the Ticketmaster/Live Nation merger. So rather than try to



predict whether they will challenge the merger, I will instead identify the kinds of issues they are likely to confront in analyzing the merger.

The Live Entertainment Industry

Ticketmaster and Live Nation are both part of the vertical supply chain that delivers live performances to fans. The “price” of this service is the difference or “wedge” between what consumers pay and what performers receive. At one end of this chain are firms that interact directly with artists, such as Live Nation. At the other end are firms that interact directly with fans, such as ticketing firms like Ticketmaster who sell tickets on behalf of venues.¹ In between is a complex group of firms offering sometimes overlapping services, including managers, promoters, venues, ticketing firms, and merchandisers.

The supply chain includes:

- Artists’ managers, who help with career decisions, help select a producer, form and lead a professional team that includes lawyers, business managers and agents, coordinate and supervise concert tours, oversee promotional activities, and perform routine business functions for artists. Artists’ managers typically earn a percentage of an artist’s gross earnings.
- Business managers, who are responsible for collecting money owed to the artist, paying bills, filing taxes, and investing any savings. Business managers work on a percentage, an hourly rate, a flat fee, or some combination thereof.

¹ Ticketmaster also owns Frontline management, which provides artists with artist management services. This business represents a relatively small portion of Ticketmaster’s revenues.



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- Lawyers, who may charge a percentage or hourly rates.
- Agents, who are mainly responsible for booking live personal appearances, including concerts, and charge between 5 and 10 percent.
- Promoters, who “purchase” concerts from agents and package them in the form of a tour or single show and market them through venues. The promoter secures the venue for the concert and is responsible for concert-related costs such as hotels, transportation and sound and lighting equipment. Promoters bear the financial risk of the concert.
- Venues, such as auditoriums, sports arenas and amphitheaters where live events are held.
- Providers of ticket services, who are responsible for selling tickets online, and possibly off-line through retail outlets at shopping malls, downtown storefronts, or other locations.

Live entertainment events generate revenues through ticket sales, parking fees, and sales of food, beverages and merchandise at the event. For every dollar of revenue generated, the artist receives only some fraction. For illustrative purposes, let us suppose that this is 80 cents. The remaining 20 cents is distributed among the various participants of the supply chain, including those listed above, in accordance with contractual (and other) arrangements that have evolved over time. This 20 cent “wedge” between what fans pay and what performers receive pays for a variety of services, including marketing and promotion activities that help bring fans to their preferred performers.



The size of this wedge is one criterion that the agencies will use to determine whether the merger is anticompetitive or not. This is important because a bigger wedge means either that consumers are paying more or that performers are receiving less, or both. In the first case, one might expect fewer tickets purchased; in the second, fewer concerts performed. This leads naturally to a second criterion that the agencies will use, the expansion of output (more seats, or more concerts). A merger that increases the size of the wedge and reduces industry output would likely be found to be anti-competitive. One that decreases the size of the wedge and increases output would likely be found to be pro-competitive.

The Merging Parties

Ticketmaster provides ticket sales, ticket resale services, and marketing and distribution services for live entertainment including concerts, professional and college sports, and the performing arts. Live Nation produces and promotes live entertainment, including music and sports events, and owns or manages venues where events are hosted. For the most part, Ticketmaster and Live Nation occupy different positions in the supply chain and perform different functions. Ticketmaster has close business ties to venues, selling and distributing tickets to a range of live entertainment events including sports. Live Nation has close business ties to artists, representing more than 1,500 artists globally as a concert promoter. Live Nation also maintains a database of fans, predominantly attendees of its live music events, but its roots are primarily in the community of performers.



Competitive Effects of the Merger

In general, antitrust analysis distinguishes between mergers that are horizontal and those that are vertical. Horizontal mergers occur between firms at similar stages of the vertical supply chain who may compete with one another in the purchase of inputs or in the sale of similar products or services. Vertical mergers are those between firms at different stages of the vertical supply chain. The theoretical analysis of Horizontal mergers is relatively well understood, and has been formalized in the joint DOJ/FTC *Horizontal Merger Guidelines*.² In contrast, the analysis of vertical mergers and relationships is less well understood and is relatively controversial.

The merger is complex because it raises both horizontal and vertical issues. Until very recently, Ticketmaster was a supplier of ticketing services to Live Nation. That is, their functions were largely complementary, or vertically related, with each firm producing different services that were combined with the services of the others to produce live entertainment. The recent efforts of Live Nation to provide ticketing services to some of its own events raises the possibility that, absent the merger, they would be a potential horizontal competitor to Ticketmaster.

Horizontal Aspects. Live Nation is not a major provider of ticketing services to third party producers of live entertainment, but in January 2009 it began self-supplying ticketing services to some venues that it controls.³ Ticketing services are already provided to third parties

² U.S. Dep't of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (1992, rev'd 1997), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104

³ I understand that Live Nation provides some ticketing services to fan clubs and artists through its Music Today entity.



by several firms including Ticketmaster, Audience View, e-Tix, ShoWare, Tickets.com, Veritix, MetroTix, and others. In addition, several other venues self-supply ticketing services. For example, several MLB teams use the MLB's proprietary ticketing service to sell tickets to fans. I understand that venues routinely consider self-supply as an alternative when they put ticketing service contracts up for bid. The software required to provide ticketing services is available from multiple sources. Live Nation is a potential competitor to Ticketmaster in the provision of ticketing services to third parties.

The Department of Justice will analyze the extent to which actual and potential competition is lost by the merger and count that as a cost of the merger. Merger analysis is typically prospective in nature, comparing the observed pre-merger world to the unobserved post-merger world, but potential competition is even more so. In this case, pre-merger competition by Live Nation for sales to third parties is not observed, and must be inferred, which makes the analysis more difficult to do.⁴

Vertical Aspects. Vertical antitrust policy is not only relatively controversial, but it is also in a state of flux. Beginning with the *Sylvania* decision in 1977, and culminating with the *Leegin* decision in 2007, courts have rejected the view that vertical restraints (such as exclusive dealing, minimum retail pricing, and maximum retail pricing) should be found illegal *per se*, and have instead analyzed these practices under a rule of reason, i.e., balancing potential benefits against potential harms on a case-by-case basis. Vertical mergers have much in common with

⁴ Such challenges can be speculative and may fail to achieve the desired pro-competitive goals. More than 40 years ago the Supreme Court ordered Proctor & Gamble to divest itself of Clorox (which it had acquired ten years earlier). An important basis for the Court's decision was that Proctor & Gamble was a potential entrant in the market for household bleach. However, forty years later Proctor & Gamble still does not produce household bleach. The blocked acquisition did not result in increased competition in the sale of household bleach, as was anticipated by the Supreme Court.



other vertical restraints, and their competitive effects can typically be established only on a case-by-case basis.

Vertical mergers often yield tangible benefits, which can be characterized under the broad heading of incentive alignment.⁵ When firms producing complementary services do business with one another, incentive conflicts naturally arise. These conflicts can be over what price to charge, how much to spend on promotion, or on how best to innovate in response to changing conditions. A merger among the providers of these services would likely help manage these incentive conflicts and result in levels of price, promotion, and innovation that would both reduce the size of the wedge between what consumers pay and what performers receive, as well as increase output.

Perhaps the most common incentive conflict is over what price to charge. *The double markup* occurs when a producer marks up the price of its product or service above marginal cost, and the next producer in the supply chain then marks up its price again, above these already marked-up input costs. You end up with a price that is too high, with too few tickets sold, or too few concerts performed. With vertical integration, the double mark-up can be reduced to a single mark-up, which would reduce size of the wedge between what consumers pay and what performers receive. This would result in lower prices, more tickets sold, more concerts performed, or all three. In popular jargon this is known as “eliminating the middleman.”

Another common conflict is over the amount to spend on promotion. If the promoter receives only a small percentage of the revenue generated by ticket sales, he might have less

⁵ See Luke M. Froeb and Brian T. McCann, “Managerial Economics: A Problem Solving Approach,” Thomson South-Western, 2008, Chapter 20.



incentive than the artist to promote the concerts. This incentive conflict could be resolved by contracts that specify the promotional activities, but these contracts may be difficult to write and enforce. If this is the case, then promotional activities might be lower than the artist or fans would want.

Innovation is another area that might be helped by this merger. The fragmentation of the supply chain means that individual firms in it may lack either the information necessary to innovate or the incentive to do so because each receives only a small slice of the proverbial pie. Innovation is relatively important to the music industry because business models are changing rapidly. If this merger gives the merged firm enough information to design more effective ways of managing the supply chain, and the incentive to do so, it can reduce the size of the wedge between what artists receive and what consumers pay.

Against these potential “vertical” benefits are potential costs as well, such as the ability of a merged firm that controls an essential input to raise its rivals’ costs or to erect barriers to entry. Economic theory, unfortunately, does not give us precise predictions regarding what types of vertical mergers are likely to harm consumers. Empirical research on vertical practices supports the view that vertical restraints, including mergers, are generally pro-competitive – the benefits of eliminating double markups and aligning incentives typically outweigh the potential consumer harm resulting from the exercise of market power.⁶ But this has to be determined on a case by case basis. In cases where there is ample existing competition and barriers to entry are low in each level of the supply chain, there is smaller risk of anticompetitive harm.

⁶ Cooper, James, Luke Froeb, Daniel O'Brien, and Michael Vita, Vertical Antitrust Policy as a Problem of Inference, *International Journal of Industrial Organization*, 23 (2005) 639– 664.

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In this case, the potential pro-competitive benefits of incentive alignment and a reduction of the double markup problem must be weighed against the potential loss of horizontal competition and the possible creation of barriers to entry. The fact-intensive investigation under way will determine the outcome. And while oversight hearings like this are a good way to see what the agencies are doing--and what they are not doing—I urge the subcommittee to not forget to ask the bigger questions as well, like “do we have the right statutes?,” “have we created the best means for implementation?,”⁷ and “do our policies achieve good results?”

These questions are extraordinarily difficult to answer, in part because we observe only what the agencies did; and not what they could have done. Transparency, disclosure, ex-post evaluation of enforcement,⁸ development of enforcement data bases, and periodic comprehensive reviews are all indicators of institutions with an interest in self-assessment, improvement, and adaptation to the changing nature of competition.⁹ One of my special interests is the development of what then-FTC Chairman Tim Muris and then-General Counsel and now Chairman Bill Kovacic call “Policy R&D,” research designed to make sure that competition

⁷ Froeb, Luke, Paul Pautler, and Lars-Hendrik Roeller, The Economics of Organizing Economists, (July, 2008), *Antitrust Law Journal* (forthcoming). Available at SSRN: <http://ssrn.com/abstract=1155237>

⁸ Froeb, Luke, Daniel Hosken, Janis Pappalardo, Economics Research at the FTC: Information, Retrospectives, and Retailing, *Review of Industrial Organization*, 25:4 (Dec., 2004) 353-374. Available at SSRN: <http://ssrn.com/abstract=592101>; and Froeb, Luke, James Cooper, Mark Frankena, Paul Pautler, and Louis Silvia, Economics at the FTC: Cases and Research with a Focus on Petroleum, *Review of Industrial Organization*, 26 (2005) 1-30.

⁹ William Kovacic, Achieving Better Practices in the Design of Competition Policy Institutions, available at <http://www.ftc.gov/speeches/other/040420compolicyinst.pdf>



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policy does not lag behind in understanding the commercial practices it regulates. The legitimacy and effectiveness of our enforcement policies depend on it.

Thank you for allowing me the opportunity to share my views on this timely and important topic.