ANALYSIS TO AID PUBLIC COMMENT ON THE PROPOSED CONSENT ORDER

The Federal Trade Commission ("Commission") has accepted agreements containing proposed consent orders from the corporate parents of the five largest distributors of prerecorded music in the United States. The five distributors, Sony Music Distribution ("Sony"), Universal Music & Video Distribution ("UNI"), BMG Distribution ("BMG"), Warner-Elektra-Atlantic Corporation ("WEA") and EMI Music Distribution ("EMI"), account for approximately 85% of the industry's $13.7 billion in domestic sales. The agreements would settle charges by the Commission that these five companies violated Section 5 of the Federal Trade Commission Act by engaging in practices that restricted competition in the domestic market for prerecorded music.

The proposed consent orders have been placed on the public record for thirty (30) days for receipt of comments by interested persons. Comments received during this period will become part of the public record. After thirty (30) days, the Commission will review the agreements and the comments received and will decide whether it should withdraw from the agreements or make final the agreements' proposed orders.

The purpose of this analysis is to invite public comment concerning the consent order. This analysis is not intended to constitute an official interpretation of the agreement and order or to modify its terms in any way.

There are five separate complaints and proposed consent orders in this matter, one for each of the distributors, which are virtually identical with the exception of minor variations related to the corporate structure of each respondent.

Analysis

The complaints allege that all five distributors have engaged in acts and practices that have unreasonably restrained competition in the market for prerecorded music in the United States through their adoption, implementation and enforcement of Minimum Advertised Price ("MAP") provisions of their Cooperative Advertising Programs.

These five companies, which collectively dominate this market, adopted significantly stricter MAP programs between late 1995 and 1996. Under the new MAP provisions, retailers seeking any cooperative advertising funds were required to observe the distributors' minimum advertised prices in all media advertisements, even in advertisements funded solely by the retailers. Retailers seeking any cooperative funds were also required to adhere to the distributors' minimum advertised prices on all in-store signs and displays, regardless of whether the distributor contributed to their cost.

Failure to adhere to the respondents' MAP provisions for any particular music title would subject the retailer to a suspension of all cooperative advertising funding offered by the distributor for an extended period, typically 60 to 90 days.[(1)] The severity of these penalties ensured that even the most aggressive retail competitors would stop advertising prices below MAP. The complaints further allege that by defining advertising broadly enough to include all in-store displays and signs, the MAP policies effectively precluded many retailers from communicating prices below MAP to their customers.

The MAP provisions were implemented with the anticompetitive intent to limit retail price competition and to stabilize the retail prices in this industry. Prior to the adoption of these policies, new retail entrants, especially consumer electronic chains, had sparked a retail "price war" that had resulted in significantly lower compact discs prices to consumers and lower margins for retailers. Some retailers, who could not compete with the newcomers, asked the distributors for discounts or for more stringent MAP provisions to take pressure off their margins.

The complaints allege that the distributors were concerned that declining retail prices could cause a reduction in wholesale prices. Through these stricter MAP programs, the distributors hoped to stop retail price competition, take pressure off their own margins, and eventually increase their own prices. The distributors' actions were effective. Retail prices were stabilized by these MAP programs. Thereafter, each distributor raised its wholesale prices.

While some vertical restraints can benefit consumers (known as "efficiencies") by enhancing interbrand competition and expanding market output, plausible efficiency justifications are absent in this case. Beneficial vertical restraints encourage retailers to provide better services to consumers than would have been provided in the absence of the restraint. However, in this case, the distributors' MAP policies provided no benefits to consumers. In particular, the new retailers that charged lower prices to consumers provided services that were as good as, and in some cases, superior to the services provided by the higher priced retailers they were moving to replace. These policies were plainly not motivated by "free-riding" concerns.

The substantial anticompetitive effects of these programs, balanced against the absence of plausible efficiency rationales for them, give us reason to believe that these programs constitute unreasonable vertical restraints in violation of Section 5 of the FTC Act under a rule of reason analysis. Although the Commission has concluded that compliance by retailers with these programs did not constitute per se unlawful minimum resale price maintenance agreements, it should be noted that the MAP provisions implemented here go well beyond typical cooperative advertising programs, where a manufacturer places restraints on the prices its dealers may advertise in advertisements funded in whole or in part by the manufacturer. Such traditional cooperative advertising programs are judged under the rule of reason. *American Cyanamid*, 123 F.T.C. 1257, 1265 (1997); *U.S. Pioneer Electronics Corp.*, 115 F.T.C. 446, 453 (1992); *The Advertising Checking Bureau, Inc.*,109 F.T.C. 146 (1987).

The market structure in which the distributors' MAP provisions have operated also gives us reason to believe that these programs violate Section 5 of the FTC Act as practices which materially facilitate interdependent conduct. The MAP programs were implemented with an anticompetitive intent and they had significant anticompetitive effects. In addition, there was no plausible business justification for these programs. *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984).

The wholesale market for prerecorded music is characterized by high entry barriers which limit the likelihood of effective new entry. In this industry, the respondents can easily monitor the pricing and policies of their competition.

The history of MAP policies in this industry also indicates a propensity for interdependent behavior among the distributors. All five distributors adopted MAP policies in 1992 and 1993 that generally required adherence to minimum advertised prices in advertisements paid for by the distributors. In 1995 and 1996, all five distributors expanded the restrictions in their MAP programs to require adherence to minimum advertised prices in advertisements regardless of the funding source. In one case, the new MAP provisions were announced four months prior to their effective date. During this four month hiatus, two other distributors adopted similar provisions. By the end of 1996, all five distributors had adopted MAP provisions that were virtually identical. Shortly thereafter, several distributors embarked on high profile enforcement actions against major discounters who were discounting prices; these enforcement actions were widely publicized by the trade press.

The Proposed Consent Order

There are five separate consent orders, one for each company.

Part I of the proposed orders establishes definitions. These definitions make clear that the provisions of the order apply to the directors, officers, employees, agents and representatives of the five distributors. This section also makes clear that its provisions apply to cooperative funding efforts regardless of whether the retailer sells prerecorded music in traditional retail stores or over the Internet.

Part II of the orders requires all of the distributors to discontinue their MAP programs in their entirety for a period of seven years. The Commission believes this relief is necessary because some of the challenged MAP programs have been in place for more than four years. Quite simply, it will take several years without the MAP restrictions to restore retail price competition.

Part III of the orders contains several prohibitions to ensure that the distributors are unable to maintain the anticompetitive status quo in some other way. Subsection A prohibits the companies from conditioning the availability of any advertising funds on a retailer's actual selling price. Subsection B prohibits the distributors from restricting the availability of any advertising funds on the basis of an advertisement funded solely by its customers that do not adhere to the minimum advertised price. Subsection C prohibits the distributors from making payments that exceed the retailers' promotional costs to ensure compliance with any MAP program. Subsection D prohibits the distributors from controlling their customers' resale prices. Subsection E prohibits, for five years, the distributors from exercising their *Colgate* rights to unilaterally terminate dealers for failure to comply with any minimum advertised or resale price.

For EMI, BMG, and UNI, Parts IV, V, and VI are various notice provisions requiring the companies to notify their customers and senior management concerning the terms of this order.

Part VII establishes that the distributors shall make annual compliance reports concerning their compliance with the terms of this order. Such reports may also be required by the Commission at any time. Part VIII establishes that the order shall terminate in twenty (20) years.

Part IV of the WMG and Sony orders specifically incorporates an exception to the prohibition against RPM that permits distributors to require their dealers to pass-through discounts. The notice and compliance requirements, and term of the order, are the same as for the other three respondents and are found at Parts V, VI, VII and VII of the orders for WMG and Sony.

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1. BMG's policy differed slightly. Under the BMG MAP provisions, the suspension of all cooperative advertising funding required a finding of two MAP violations. However, BMG MAP provisions also established a suspension of up to a year for repeated violations.