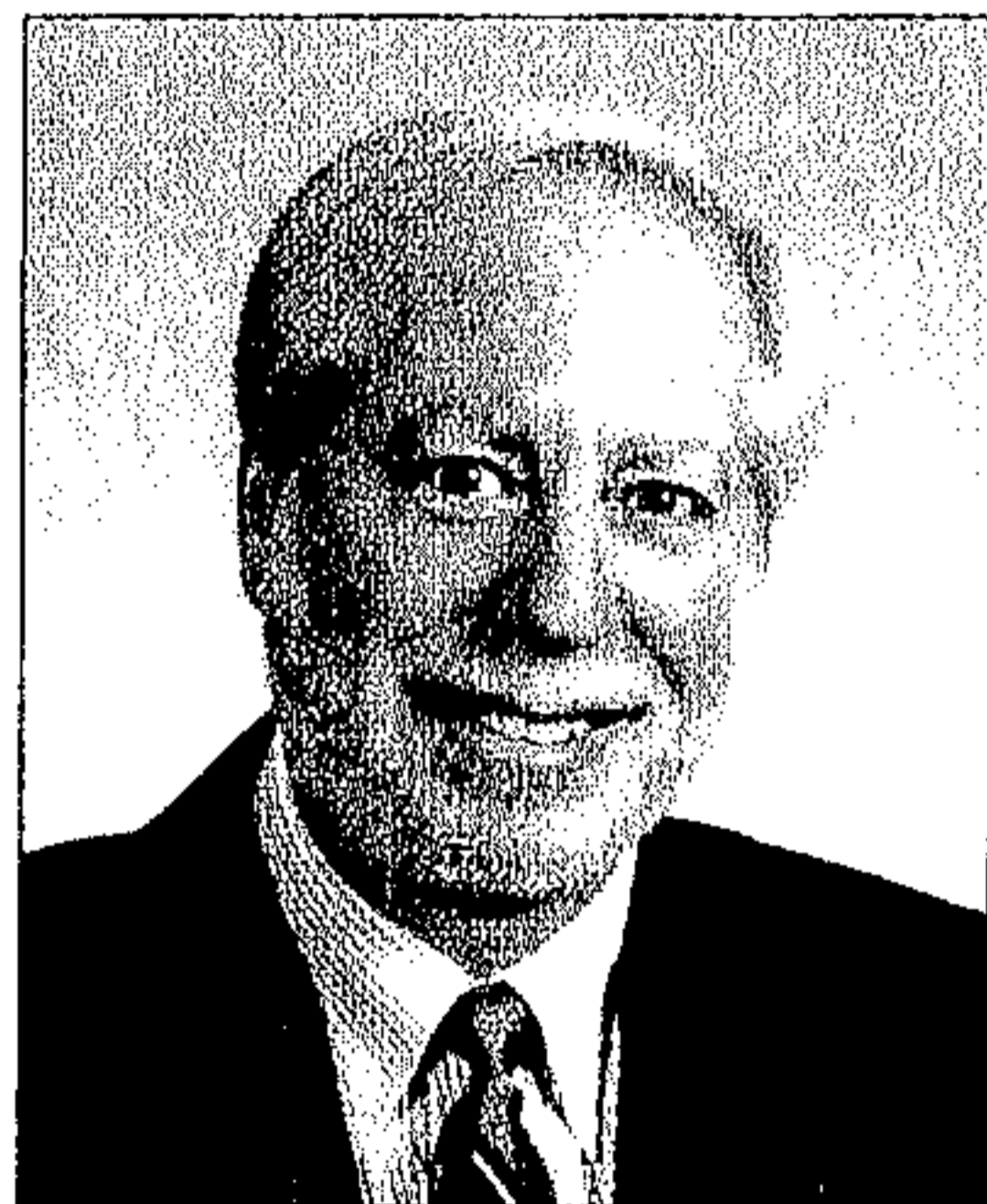


FTC Investigation Update: A Light at the End of the Tunnel?



Former FTC attorney David Federbush.



NAMM lawyer Veronica Kayne.



Law professor Jubba Ghosh.

There have been multiple developments on the ongoing FTC investigation into the music products industry, and the smoke is clearing to cull facts from wild guesses, reality from rumors. And according to a law professor and a former Federal Trade Commission (FTC) lawyer, any hope this investigation would be defused by the recent Supreme Court decision that to some extent allows manufacturers to set prices on their products has turned out to be wishful thinking.

Most important, some closest to the case are now betting on a dismissal, and in the not-to-distant future.

NAMM president and CEO Joe Lamond saw fit to devote the opening portion of his Summer NAMM state-of-the-industry address to a Q&A with NAMM's attorney Veronica Kayne of the law firm Haynes and Boone on the issue. Lamond set the tone by acknowledging the investigation "has cost into the six figures in legal fees" for several companies and organizations.

At the core it all comes down to this: are music instrument makers conspiring to fix prices?

We do know that the FTC has recently "narrowed the scope" of the investigation and is focusing on investigating the possibility of price-fixing as it relates to MAP, and looking into whether or not competitors are talking to each other illegally in this regard. "My best guess is that the FTC is not interested in any one manufacturer's

policy," Kayne said. "They are looking at parallel or collusive activities with respect to Minimum Advertised Price (MAP) policy," she added at a July 27th NAMM breakfast meeting. She termed this focus as an investigation of "horizontal" conduct (manufacturer-to-manufacturer) as opposed to "vertical" conduct among manufacturers, distributors, and retailers.

An *MMR* source close to the case and speaking on the condition anonymity said that the FTC is in fact comparing apples and oranges — they are not comparing the pricing activities of one guitar maker to another, for example, but comparing a guitar maker to a brass instrument maker. It's as if they don't understand the differences between the instruments or that they'd be absolutely no benefit for a pro audio company to be in cahoots with a string instrument manu-

facturer and share where they are going to set MAP pricing.

Typically the modus operandi is that the FTC investigators look for one "culprit" and gets him or her to cop a plea in exchange for testimony. That is how the commission broke the case against the 2000 case the FTC won against the five biggest distributors of recorded music. That case was against Universal Music and Video Distribution, Sony Corp. of America, Time-Warner Inc., EMI Music Distribution, and Bertelsmann Music Group (BMG), the five largest distributors of recorded music. In that case, the FTC required these companies, which had a total combined market share of 85% of all CDs bought in the U.S., to discontinue MAP programs completely for seven years.

That case was lead by FTC lawyer William L. Lanning, who is the leading lawyer in the currently investigation. In an interesting twist, NAMM's lawyer, Veronica Kayne, was once Lanning's boss when she was employed by the FTC.

Another rumor regarding how this case got started has turned out to be true. While there were multiple ways this investigation could have been brought about,

another source has confirmed that an FTC investigator said that it was a small group of disgruntled dealers hoping to "level the playing field" against Guitar Center and other large-scale competitors. But no doubt this group, more than three but less than 10, had no idea the damage to the industry as a whole they would end up causing.

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-- Attorney Virginia Kayne

Finally, looking for levity in this situation is a challenge, but here's a tidbit: one high-level MI industry official had his computer confiscated by an FTC agent only to have it returned later with less

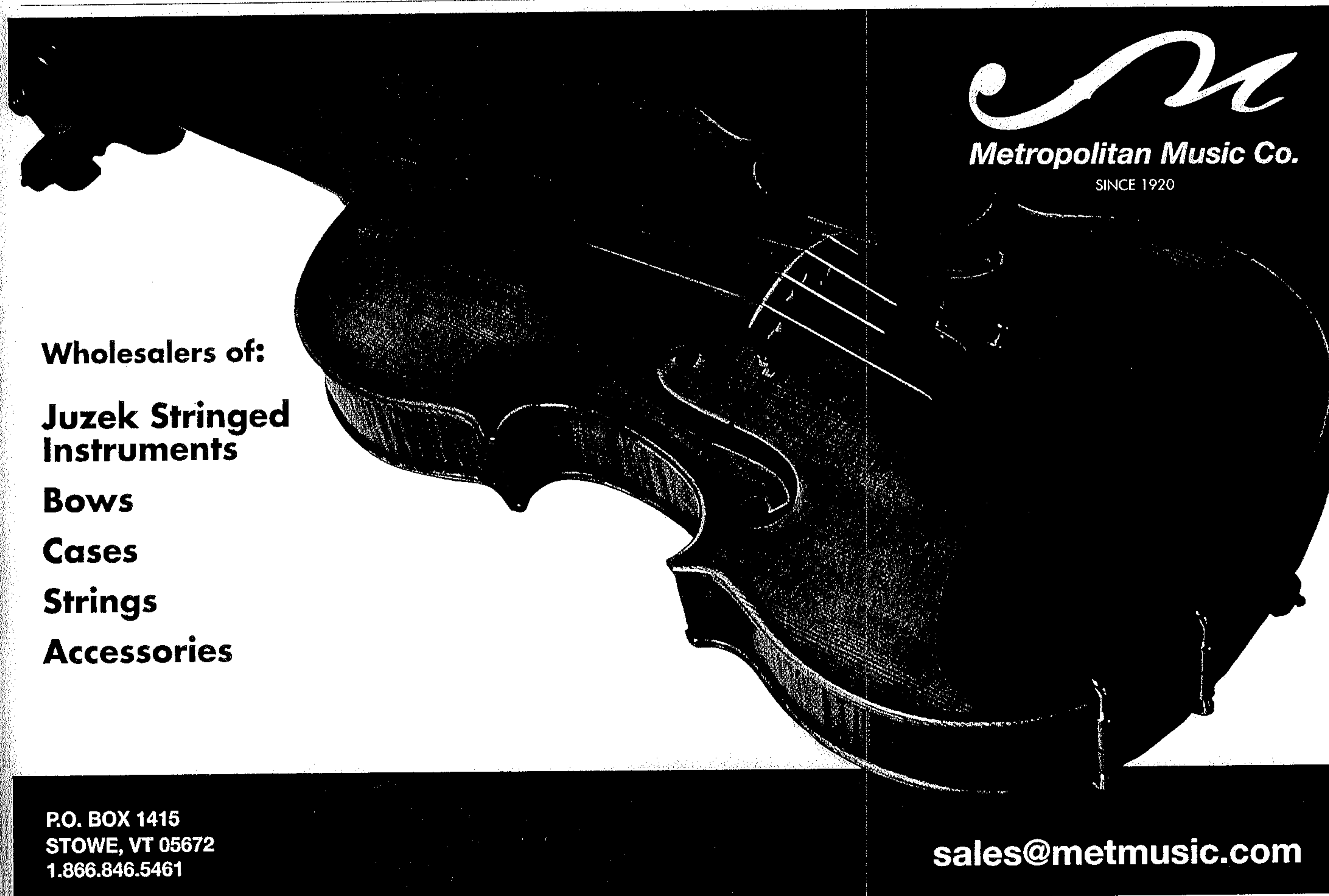
than a ringing endorsement about his life's work: he was told by the agent that he now knows everything about the music retail industry and finds it completely boring, and that he'd never want his job.

Leegin v. Reality

While it is now believed the recent Supreme Court decision will have no effect on the FTC probe, it remains a major shift with repercussions for all industries including this one. In June, in a 5-4 decision on the

Leegin v. PSKS case, the Supreme struck down an antitrust rule dating from 1911, ruling that it is not necessarily unlawful for manufacturers and distributors to agree on minimum retail prices. For court-watchers it was not a surprise given the more conservative, pro-business slant the court has taken recently.

"The only safe predictions to make about today's decision are that it will



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likely raise the price of goods at retail and that it will create considerable legal turbulence as lower courts seek to develop workable principles," Justice Steven G. Breyer wrote in his dissenting opinion. "I do not believe that the majority has shown new or changed conditions sufficient to warrant overruling a decision of such long standing."

Initially some in this industry thought that if now that manufacturer's were allowed to dictate the price retailers sold their products, why continue with a suit that is suspicious that MI's MAP policy

is being abused to effectively tell retailers what to *price* their product at?

"I don't think it 's the least bit likely that this decision will result in the closing of the FTC's MAP investigation," says Federbush. "First, the recent Supreme Court decision didn't hold (minimum) resale price maintenance polices are *all* legal; it just held that they must be analyzed under the 'Rule of Reason' to determine if they're violations, rather than be ruled automatically illegal under a 'per se' rule.

"Also, remember that MAP polices aren't (minimum) resale price restrictions,

but rather are restrictions only on the minimum prices that can be advertised. They're still analyzed under the 'Rule of Reason.'" He adds that the current FTC, which has been in favor of the position recently taken by the Supreme Case Leegin case, has also supported the MAP investigation of the music products industry. "There is nothing inconsistent about being in favor of doing away with the 'per se' rule against retail price maintenance, and concurrently being against MAP programs that, on balance under a 'Rule of Reason' analysis, have more anticompetitive than pro-competitive economic effects."

As for what it all means for customers: "Consumers should expect fewer discounts for certain boutique or high-end products, and perhaps better service in some retail outlets," Shubha Ghosh, Professor of Law at Southern Methodist University's Dedman School of Law says. "In general the ruling should mean higher prices. How much is hard to predict. Justice Bryer estimated something to the order of \$750 to \$1,000 a year for the average household, but that strikes me as high."

Ghosh, who writes and teaches on antitrust issues, adds that less price competition in general will be a good thing for retailers who have found it hard to survive in a competitive marketplace and naturally, profit margins may be higher as a result. But overall, "the result is very pro-manufacturer. The decision read as a whole gives manufacturers much more leeway in setting contractual terms and imposing them on retailers."

Ghosh continues: "I think both the majority and dissent wrote very strong opinions that just framed the issue in contrary ways. I have to say that this is one of the most engaging and thorough antitrust opinions in a long time, perhaps the most engaging opinion on competition policy issues in general."

A call into the FTC public affairs specialist Mitchell Katz got this response: "I've been asked if the ruling on *Leegin v. PSKS* will affect on-going investigations related to concerns about price fixing," Katz said. "We need to evaluate it and see what if any impact it will have. Of course, we wouldn't talk about it publicly and I couldn't say anything about where the investigation stands, but we take all case law into consideration, and certainly a Supreme Court decision is case law."

The FTC reportedly will make a public statement about the case this month.

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