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# The Antitrust Implications of Minimum Advertised Pricing: The Case of the U.S. Music Industry

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## ABSTRACT

*In May 2003, without admitting wrongdoing, music distributors and retailers settled with private plaintiffs and the Attorneys General of 43 States a civil suit regarding a conspiracy to inflate or support prices of prerecorded music products through an industry-wide strengthening of the music distributors Minimum Advertised Price (MAP) policies. The settlement leaves as an*

*open question the proper economic and legal standard (rule of reason versus per se) to be adopted in such cases.*

*MAP had both horizontal and vertical implications and may have facilitated a horizontal conspiracy between the music distributors. The MAP policies were alleged to be equivalent in effect to Retail Price Maintenance (RPM). The Federal Trade Commission (FTC) claimed that prices increased by approximately \$2 per CD and that consumers paid an extra \$480 million. The effectiveness of the MAP program in raising prices was due to the all-encompassing nature of the advertising restrictions, the industry-wide implementation of MAP programs, the payment and significance of the advertising subsidy, and the severe penalties imposed for a MAP violation. This paper illuminates the antitrust implications of MAP policies through consideration of related practices in the United States market for music CDs. When viewed from this vantage point, MAP appears to be as pernicious as RPM.*

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## KEYWORDS

Antitrust – Retail Price Maintenance – Minimum Advertised Price – Collusion – Cooperative Advertising - Music Industry

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## INTRODUCTION

In May 2003, without admitting any wrongdoing, music distributors and retailers reached a settlement agreement with private plaintiffs and Attorneys General of 43 States regarding a conspiracy to inflate or support prices of prerecorded music products through the strengthening of Minimum Advertised Price (MAP) policies. The settlement was valued at over \$143 million and would benefit numerous retail CD purchasers. Historically minimum advertised prices were set by the distributors on CDs whose advertising was partially subsidized by the distributor – a practice known as cooperative advertising. Since the Federal Trade Commission (FTC) matter was resolved by the signing of a consent decree without admission of fault and the private civil suit was settled it leaves as an open question the proper economic and legal standard (rule of reason versus per se) to be adopted in such cases. This paper illuminates the antitrust implications of minimum advertised price (MAP) policies through consideration of related practices in the U.S. market for music CDs. 1

## BACKGROUND

The recording industry primarily served the markets for prerecorded musical performances in the mid to late 1990s through the sale of full-length compact discs (CDs) and cassette tapes (tapes). Five major distributors sold and distributed over 85 percent of all prerecorded music in the US. This concentration is a result of a wave of mergers in the last half of the twentieth century when independents were bought by major distributors. These major distributors are Warner-Elektra-Atlantic Corporation; Universal Music and Video Distribution Inc.; EMI Music Distribution, Inc.; Sony Music Entertainment, Inc.; and Bertelsmann 2

Music Group. The major distributors sold CDs to numerous retailers including independent retailers, large national chains, mass merchandisers such as Target, Wal-Mart and K-Mart, regional chains, and consumer electronics stores such as Circuit City and Best Buy. They also sold music to sub-distributors or rack-jobbers, which supply retailers who are not serviced directly by the distributors. Over this period, the retail record store business became increasingly concentrated due to mergers, bankruptcies and the expansion of mass merchandisers with the 4 largest firms controlling 46.8 percent of record store sales in 1997 (U.S. Census Bureau, 2000)

The competitive environment in music retailing had dramatically changed in the early 1990s. The major consumer electronics stores and several mass merchandisers expanded their music offerings and used discounted prices on CDs to increase store traffic and awareness. The price competition from electronics stores and mass merchants threatened the viability of traditional music outlets causing about a dozen chains to file for bankruptcy and over 1,000 independent stores to close (Christman, 2001, p. 2). The structural shift in music retailing is evidenced by industry data on the pattern of purchases over the last decade. These data show that in the late 1980s over 75 percent of sales took place in record stores. The record stores' share fell to 60.0 percent in 1992 and to 42.5 percent by 2000 (The Recording Industry of America, 2001, p. 1). The data also show that the record stores lost a large part of their sales to the mass merchandisers and consumer electronics stores. The share of sales for these distribution channels, which are combined in the Recording Industry Association of America (RIAA) Consumer Profile as the "other store" category, grew from 15.6 percent in 1989 to 42.4 percent in 2001. 3

In response to the increasingly competitive retail environment, the traditional music retailers asked distributors to strengthen MAP policies in order to restrain price competition. The scheme is alleged to have begun in February 1995, when the CEO of Musicland, Mr. Jack W. Euster, stated in his presidential Keynote Address to the National Association of Recording Merchandisers (NARM) distributors and retailers: 4

This discussion brings us then to retailers, distributor and music company partnerships. More than ever these partnerships need to be tightened. Our industry health is going to depend on proactive programs that are targeted to prevent the devaluation of CDs. As record companies, be wary of marketers who use your products as skills, come-ons and loss leaders for other merchandise. (Case CV00-10781R, *O'Brien v. Time Warner*, [2001] Complaint <http://www.angelfire.com/biz2/savicom/TWcomplaint.html>, pp. 9 – 10).

Originally the distributors did not respond to the speciality stores' request. However, when the distributors saw many speciality stores going bankrupt, they responded by strengthening the existing MAP policies. It is likely the distributors realized that increased market power in the retail market could lead to less market power for the distributors and thus lower long run profits. 5

## DESCRIPTION AND IMPLICATIONS OF MAP

Retail stores carry out considerable amounts of advertising. These retailers have to choose which of the many products that they sell will be featured in their advertisements. Distributors of CDs want their product promoted in these advertisements. In order to get their product advertised the distributors will pay a fee to the retailers. This is termed co-operative advertising in that the retailers and distributors are jointly paying for the cost of these advertisements. A condition of these co-operative advertisements is that the retailer agrees not to advertise at a price below MAP in the advertisements that are jointly funded. 6

However, historically the retailers were allowed to price below MAP in non-co-operative advertisements, that is, those advertisements that were paid for entirely by the retailer. The MAP policy that was questioned by the FTC does not allow for co-op funds to retailers if prices in any advertisements were below MAP. 7

Although the MAP policies of distributors technically allowed retailers to price their product at whatever price they wanted, the retailers were not allowed to communicate to consumers via media or in-store advertising that they were willing to sell CDs for less than the respective distributor's MAP. Even if they paid entirely for the advertisement or in-store display, they would not receive the benefit of the revenue from cooperative advertising. It appears that the loss of this revenue was considered significant from a profitability standpoint. Even retailers that were sceptical of the distributors' MAP policies fell into line because the financial consequences of violating MAP were considerable. Some retailers could lose millions of dollars in co-op advertising if they did not adhere to the distributors' MAP policies (Christman, 1996b, p.86). Thus, co-op advertising provided a cost advantage to stores receiving these payments. The MAP policy had considerable influence on price but some retail firms initially found innovative ways to circumvent MAP. For example, Circuit City in parts of June and July of 1996, devised a new market strategy to circumvent MAP. It ran a campaign that advertised "every CD \$11 or less." Although in fine 8

print it stated that WEA, Sony and UNI products were excluded, Circuit City actually charged \$11 for these CDs too - as was shown by a cash-register receipt that was faxed to Ed Christman of Billboard (Christman, 1996c, p. 76). As the MAP policies were strengthened it became more difficult for retailers to circumvent MAP as other retail stores kept a watchful eye and reported alleged cheating. Retailers would look for print advertisements of competitors that were violating MAP and promptly send such ads to the distributor whose MAP policy was being violated. Even though retailers were free to price at whatever level they wanted, the potential loss of millions of dollars in co-op revenue induced them to follow the more stringent MAP policies. The MAP policies of distributors and their impact on retailers were summarized in one newspaper article, which explained that most retailers took the MAP co-op funds which effectively ended price competition for the best-selling CDs. The distributors had defended this policy, arguing that it prevented bloodletting in the retail music business and kept smaller chains and independent stores in business (Segal, 2000, p. 2). Mr. Euster in his Keynote Address proclaimed:

For years, wholesalers in many industries have found that minimum advertised price programs to qualify co-op dollars have been especially effective in supporting the value of perceptions of their merchandise. Most music companies and movie studios have MAP programs. These programs accomplish their goals best when the MAP price is sufficiently above wholesale cost as to not devalue the product in the consumer's mind. Also, effective MAP programs consider in-store pricing as well as advertised prices and condition co-op support for the entire ad on MAP compliance. What else can we do together? (*O'Brien v. Time Warner* [2001] p. 10).

During the period of the alleged conspiracy, price increases did occur as demonstrated by a number of sources. Industry publications acknowledged the price increases. For example, an article in Billboard entitled "MAP Policies Bring Price War Cease Fire" stated, "Discounters' use of loss leader pricing strategies is falling by the wayside as major distributors take a tougher stance on minimum-advertised pricing. Thanks to the majors' new-found resolve on MAP, prices of hit CDs at discount chains rose by \$2.00 to \$11.99 over the last month, industry observers say" (Christman, 1996, p. 3). The FTC estimated that during the period of 1996-1999 when MAP was practiced consumers paid \$480 million extra for CDs. In addition to large discount retailers, new and small firms were unable to compete effectively. Robert Krughoff explained: "MAP policies deny small firms the opportunity to use low prices to get visibility and a foothold against established competitors" (Spencer, 1993, p. 2).

Gary Arnold, VP of Marketing for Best Buy complains "that the problem with MAP is that more or less sets a price point for all merchants regardless of what a retailer's cost of business is." For example, Arnold claims "some music retailers' SG&A (selling, general and administrative) expenses are as high as 40% of sales, whereas Best Buy's are only 13%" (Jeffrey, 1997, p.75). He questions the wisdom of having firms with such divergent costs selling at the same price. The MAP policy as enforced in the CD market seems to be simply an attempt to appease the speciality stores. The speciality stores, whose primary source of revenue is the sale of CDs, did not want to compete with the mass merchandisers and thus requested that the distributors vigorously enforce MAP and tighten the policy so that price competition would not exist in the market.

## PER SE ILLEGAL AND RULE OF REASON

The two principal laws governing antitrust in the US are the 1890 Sherman Act and the 1914 Clayton Act. These acts are further extended by the 1914 Federal Trade Commission Act. When applying these Acts, the courts apply one of two standards: the action of the defendants is considered either per se illegal or determined under a rule of reason. Per se violations are illegal in and of themselves and the only defense allowed is that the defendant did not commit the act. Under the rule of reason the issue is whether the conduct was unreasonable based on its economic impact and thus in violation of antitrust statutes. Black's Law Dictionary (1990, p. 1332) defines the "rule of reason" as follows:

Under the rule of reason test ... the fact finder must weigh all circumstances of the case to decide whether practice unreasonably restrains competition, and the test requires the plaintiff show anticompetitive effects, or actual harm to competition, and not whether the practices were unfair or tortuous (*Richard Hoffman Corp. v. Integrated Building Systems*, 610 F. Supp. 19 [1985] p. 22).

Thus, under the rule of reason, the reasonableness of the practice is determined on a case-by-case approach and the burden of proof is on the plaintiffs.

With regard to per se violations, the Supreme Court in *Northern Pacific Railroad Co. v. U.S* (356 U.S. 1 [1958]) stated that "there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiring as to the precise harm they have caused or the business excuse for their use." Currently, price fixing, output restraints, minimum resale price maintenance, and allocation of

customers among competitions are considered illegal per se. Black's Law Dictionary (1990, p. 1142) defines the per se doctrine as follows:

Under the "per se doctrine," if an activity is blatant in its intent and pernicious in its effect, a court need not inquire into the reasonableness of the same before determining that it is a violation of the antitrust laws. (*Connecticut Association of Clinical Laboratories v. Connecticut Blue Cross, Inc.* 324A.2d288 [1973] p. 291).

A per se rule assumes that a particular practice (i.e., price fixing or minimum RPM) is so detrimental to competition and generally lacks any justifications in terms of promoting competition that courts are not required to review the details of the case. The conduct is illegal per se. In other words, a per se prohibition implies that the conduct is always unreasonable. A rule of reason prohibition requires a thorough review of the potential benefits and detrimental effects of the conduct. Here, the courts must weigh the various arguments put forth in order to decide whether the restraint is reasonable, and therefore compatible with the Sherman Act. Hovenkamp (1999) has suggested that the most difficult aspect of the jurisprudence of the per se rule is "determining when it should be followed." This is because, once such a characterization is made, the legality of the practice is determined without inquiring into the market structure. Such a determination requires that the conduct can be recognized as harmful to competition and therefore, should be held illegal from the outset. 14

In *United States v. Socony Vacuum Oil Co.* (310 U.S. 150 [1940]) the Supreme Court declared that any combination tampering with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered or stabilized prices they would be directly interfering with the free play of market forces. 15

MAP in this case is alleged to have stabilized prices. However, a vertical restraint is not illegal per se unless it includes some agreement on price or price levels. In *Continental T.V., Inc v. GTE Sylvania Inc* (433 U.S. 36 [1957]) the Court refused to extend per se illegality to vertical nonprice constraints stating that "departure from a rule of reason standard must be based on demonstrable economic effect rather than...upon formalistic line drawing." The Court concluded that "vertical restraints had not been shown to have such a 'pernicious effect on competition' and to be so lack[ing] [in]...redeeming value as to justify per se illegality... Rather, we (the Court) found they had potential to stimulate inter-brand competition, 'the primary concern of antitrust law'" (Handler, 1997, p. 656). Thus, the rule applied in horizontal cases regarding agreements "affecting price" is much broader than that applied to vertical agreements. The Music Distributors' MAP policies did not technically restrict pricing (they were allowed, albeit possibly without advertising reimbursement, to charge any price they wished). Yet MAP policies restricted the advertising of prices, which directly impacted retail prices by restricting retail price competition. Nevertheless, the case would have been judged on a rule of reason basis (United States District Court of Maine, MDL Docket No. 1361, Decision and Order on Notice, Settlement Proposals, Class Certifications and Attorneys fees, p. 30). 16

However, the relevant economic question is not whether an arrangement sets a specific price level but whether the arrangement caused prices to be higher than they otherwise would have been. That is, does the practice eliminate or greatly attenuate price competition? 17

The Supreme Court of the United States has the final say on what is considered illegal per se and what is decided under rule of reason (*State Oil Company v. Khan* [1977] 522 U.S. 3). For example, in 1997 the Supreme Court ruled that maximum resale price maintenance (RPM) is no longer considered illegal per se and thus comes under the rule of reason. However, minimum resale price maintenance is still considered illegal per se. This suggests that if MAP was considered equivalent to RPM then it might be a per se violation. In such a case, there would not be any need to determine if the agreement actually injured competition. However, given the trend towards more lenient treatment of vertical restrictions that conclusion is by no means certain and again there is the unfortunate aspect of not having a judicial finding. 18

## THE FTC COMPLAINT

In the music CDs antitrust litigation, the FTC charged that the five distributors modified their MAP policies to induce retailers to charge higher prices for CDs. This behavior is, at least at first blush, perplexing since theory would suggest that the music distributors would want retailers to charge low prices once the distributors charged their "best" price because the quantity of CDs that retailers sell is greater at lower prices (Posner, 2001). This suggests that it is in the interest of the distributors to have low retail prices because this would increase the distributors' profits. 19

The FTC's actions were based on two different legal theories. First the Commission found that the more stringent MAP programs individually constituted a vertical restraint in violation of Section 5 of the FTC Act 20

under a rule of reason analysis. Second the Commission also found that the arrangements were practices that facilitate horizontal collusion among the distributors (Leary, 2000, p. 2).

The FTC contended that the MAP policy did not represent a clear-cut resale price maintenance agreement and thus was not illegal per se. FTC Chairman Robert Pitofsky stated there was no explicit agreement on pricing and that "in our view *Sharp Business Electronics Corp. v. Sharp Electronics Corp.* (485 U.S. 717 [1998]) requires something more than a showing that an agreement has some influence on price" (Pitofsky et al, 2000, p. 1). That is, there is a presumption in favor of a rule of reason standard and that departure from that standard must be justified by demonstrable economic effect, such as the facilitation of cartelizing. As to the facilitating practice theory, the FTC found that:

The market structure in which the distributors' MAP provisions operated, the fact they were implemented with an intent to stabilize prices, the significant price effects, and the lack of compelling business justifications gave the Commission reason to believe that the practices materially facilitated interdependent conduct (Leary, 2000, p. 5).

The Commission found that this MAP program exceeded previous MAP policies by "including advertising paid for entirely by the retailer, and they also applied to in-store advertising, excepting only the smallest price labels affixed to the product." The result of MAP was to stabilize retail prices and raise wholesale prices. The FTC determined that there was "no plausible efficiency rationale" for MAP and that the mass merchandisers and consumer electronic stores were not "free riding" on services provided by traditional retailers (Leary, 2000, p. 3). Free riding is the principal argument made by defendants in retailer restriction cases and exists when pre-sale service is important. For example, full service retailers that provide good pre-sale service can be undercut by discount retailers that do not provide the pre-sale service, thus, in turn, reducing the full service retailer's ability to offer such services. In this case, MAP could be justified if free-riding on the part of mass merchandisers and consumer electronics stores was taking place because MAP would allow higher margins which would support the desired pre-sale services. In the CD market, however, it was never established that pre-sale service was important. It might be argued that distributors wanted to increase the amount of non-price competition among the dealers to stimulate point of sales services. For example, distributors might try to defend their actions on the basis that CDs cannot be marketed effectively unless the retailers maintain a large CD inventory with listening stations, a deep catalogue and knowledgeable sales people. In other words, distributors might try to defend their actions on the basis that if a distributor increases the minimum resale price that exceeds the cost of reselling the product, the retailers will increase the provision of such services.

The European Commission also investigated the vertical relationships among the five major recording companies and their retailers. The investigation focused on allegations of resale price maintenance through the use of contracts with retailers where co-operative advertising arrangements were linked to MAP. However, on August 20, 2001 the European Commission suspended the investigation when the companies agreed voluntarily to end the practice (*EU Closes Inquiry*, 2001, p. 184).

### **DISTRIBUTOR'S MINIMUM ADVERTISED PRICE POLICIES ALL CONTAIN PROVISIONS WHICH SUPPRESS RETAIL PRICE COMPETITION**

In the civil action in federal district court, plaintiffs focused on the horizontal implications of MAP. Plaintiffs alleged that similar MAP policies were enacted by each of the major distributors, for the purpose of suppressing retail price competition and consequently increasing the price of CDs. The distributors appear to have achieved this goal in the 1996-1997 period by strengthening existing MAP policies to such a degree that retailers were effectively disabled from pricing CDs independently. Industry observers claim that as a result of MAP, prices of CDs at discount chains increased from \$9.99 to \$11.99 in one month (Christman, 1996a, p.3). This was accomplished by withholding all co-op funds unless retailers displayed prices above MAP specified minimums in all media advertisements and in-store displays including those paid for entirely by the retailer.

### **LIMITATIONS ON RETAILERS EXCEED THOSE FOUND IN TRADITIONAL MAP POLICIES**

It has been argued that the limitations placed upon retailers in the music industry exceed those found in traditional MAP policies. For example, Elahi (2001, p.20) states, "these restrictions went beyond those of traditional MAP programs that restricted solely the prices in the advertisements paid for by the manufacturers." Music retailers were also required to adhere to the distributors' MAP policies on all in-store signs and displays regardless of whether the distributor contributed to their costs. In traditional co-operative advertising programs, manufacturers help dealers pay for advertising or promotions, with the condition that advertisements supported by the manufacturer cannot include any price advertising unless the prices are at or above suggested levels. Unlike the MAP policies supported by the music distributors, dealers are free to advertise price at whatever level they choose when they buy their own advertising. Further, a MAP violation in any store in a national or regional chain implied a loss of co-op funds for the entire chain. Elahi (2001, p. 21) describes the effect of the policies: "Compliance with the MAP policies –

which was secured through significant financial incentives – effectively, eliminated the retailers’ ability to communicate discounts to consumers. This inability to effectively communicate discounts to consumers meant that retailers had little incentive to actually sell product at a discount.” Before the more restrictive new MAP policies some retailers would use low price CDs to attract customers into their stores. This was in the hope that these consumers would purchase other items once they were in the store. However, if the retailers were forced to advertise at MAP in all advertisements this inducement would not exist and there would be little reason for the retailer to discount the price once the customer was already in the store.

### TRANSACTION PRICES ARE RELATED TO MAP PRICES

MAP directly affected CD prices by impeding retail price competition and consequently causing an increase 26 in retail prices. This inference follows logically from the following three facts. First, the distributors’ MAP policies effectively imposed minimum prices through advertising restrictions combined with the loss of significant advertising subsidies for retailers that violate MAP. Second, all of the major distributors imposed similar MAP policies with common price restrictions on the key price points as noted above. Third, the major distributors with assistance from some retailers rigorously enforced these MAP policies. When artificial restrictions prevent competitors from providing price information, price competition will also be restrained because the restrictions eliminate the competitive advantage obtained from lowering prices. That is, the increased sales that would come from advertising lower prices. This suggests that if one cannot advertise price below MAP then this leaves only the reduction in revenue from anyone who would have bought CDs from the retailer at higher prices. When advertising below MAP prices is allowed, price-cutting retailers would get a compensating increase in sales as additional customers came in to purchase CDs at advertised prices.

Confirmation of the alleged relationship between MAP and transaction prices is found in the following 27 excerpt from Variety:

Better known in music circles by the acronym MAP, the system was essentially a pact between some music retailers and the major label groups that set a mutually agreed-upon floor for retail CD prices. ... The response from the big five was to tie the financial support they gave retailers for advertising to an agreement from retailers that they would not advertise below a certain level. The strategy kept the discounters at bay, maintaining pricing at more or less consistent levels for all players (Oppelaar, 2000, pp. 1-2).

The MAP policies of distributors essentially led to all retailers abiding by MAP, which thus efficiently 28 forestalled price competition.

### MAP’S EFFECT ON PROFITABILITY

The significance of MAP and its effect on pricing and profitability is demonstrated by the “Industry and 29 Competitive Environment” discussion contained in Trans World Entertainment Corporation’s 1998 Form 10-K, which is the annual financial report that a corporation must submit to the United States Securities and Exchange Commission. This states:

During 1996, many of the major music vendors began to enforce programs such as the Minimum Advertised Pricing (“MAP”) program to eliminate loss-leader pricing strategies. These programs penalize sellers that fail to comply with vendor pricing programs by limiting advertising support. The enforcement of the MAP program has been successful in stabilizing prices in the industry. Non-traditional music retailers have since reduced their music and video selections and maintained less aggressive pricing policies (Trans World, 1998, p. 5).

The profitability of retailers, as reflected in the companies’ stock market values, significantly increased 30 during the period that the MAP restrictions were expanded:

The US music chains and their wholesale suppliers, several of which have been in bankruptcy are finally turning around as they move through the critical fourth quarter. Wall Street is watching the recovery, and recent music chains’ stock price highlights the critical fourth quarter. Trans World’s stock price was \$32 in late October, up from 52-week low of just over \$5; Musicland Group was up to \$6 recently from a low of 69 cents last December; and National Record Mart was up to \$2.69 from \$1.13 (Paige, 1997, p. 1).

The increase in the stock prices is not dispositive but it is consistent with the impact that MAP is alleged to 31 have had on prices and profitability.

### THE COMPETITIVE EFFECTS OF ELIMINATING MAP

There was a fear in the industry that the elimination of MAP would re-ignite the price wars that existed in the recording industry in the early nineties. One publication stated, "Merchants privately say that the elimination of MAP rekindles fears that the price wars will break out and return music retail to the unprofitability it suffered from 1994-1996, before the strong MAP policies were adopted and enforced" (Christman, 2000a, p.1). 32

Robert Higgins, CEO of Trans World Entertainment Corporation stated "(t)here was a very aggressive pricing environment, the most aggressive we have seen in almost 10 years, due to the electronic superstores and mass merchants deciding to take advantage of the FTC-mandated elimination of the majors' minimum-advertised-price policies" (Christman, 2001b, p.2). Another article stated, "Like other industry players, Universal fears that a price war could break out again. In the last price war, which occurred from 1994-96, about a dozen chains filed for bankruptcy protection and more than 1,000 independent stores closed, according to industry sources" (Christman, 2000, p.2). This pattern of consolidation is similar to that found in other market segments where more efficient competitors eliminated many independent retail establishments. It should be realized that this "creative destruction" is consistent with a properly functioning market mechanism (Schumpeter, 1950). Further, elimination of MAP is consistent with current antitrust practice, which strives to protect competition, not competitors. 33

### THE ECONOMICS OF MAP

The economics of MAP is complicated because higher retail prices do not appear to be in the distributors' self-interest. The difference between the CD distributors' price and the retail price is the distributors' cost of distribution, and sellers want to minimize that cost. Alternatively, a high retail price reduces the demand for CDs and hence the distributors' sales revenue. From this perspective, it appears that it is not in the distributors' self-interest to promote higher prices in the retail sector (Posner, 2001, p. 172; Viscusi, 2000, pp. 229-30). 34

Economic theory suggests several explanations for why manufacturers nonetheless often restrict competition in the distribution of their goods (Posner, 2001, pp. 172-73). First, the distributors may be acting on behalf of the dealers. That is, some retailers want to fix prices, as evidenced by the keynote address of Jack Euster, and somehow enlisted the aid of the distributors to act as their agent in administering the cartel. This was accomplished by the distributors' enforcement of MAP. It should be noted that the success of this alleged conspiracy resulted from the fact that the retailers were able to enlist the support of all the distributors. Perhaps distributors supported this arrangement because it allowed them to maintain wholesale prices at somewhat higher levels than they otherwise would have been. 35

A second explanation (and perhaps the most plausible of the four) is that distributors wanted to restrict the emergence of bilateral monopoly in the U.S. market for CDs. In the early nineties none of the speciality stores had a significant share of sales and it is likely given the level of concentration that the distributors had considerable control over the price that they could charge for CDs. As some of the speciality stores began to fail, the distributors may have realized that over time Wal-Mart, Target, Best Buy and Circuit City would have increased market power. During the time when MAP was not enforced about a dozen chains filed for bankruptcy and more than 1,000 independent stores closed (Christman, 2000b, p. 5). This could eventually result in the distributors facing an oligopsony (which exists when there are few buyers in the market). Under this market structure the distributors would have less control over the price that they could charge retailers, which could lead to lower profits for the distributors in the long-run. 36

A third reason for MAP relates to the possibility that there is price-fixing at the distributor level. In this context MAP would serve as a facilitating mechanism to prevent cheating by the distributors since cheating with an effective MAP program would offer little benefit to distributors. Retailers would not be able to advertise the lower prices and expand their sales of the cheating distributors' product. Fourth, the distributors may have increased retailer margins through MAP to encourage non-price competition in point-of sale services. Perhaps CDs can be marketed more effectively with large catalogues, listening stations and knowledgeable sales people. If the manufacturer restrains price competition and increases margins above the marginal cost of providing distribution services without the point-of sale services, then retailers should increase the level of non-price competition. 37

### CONCLUSION

The facts presented above suggest that MAP had a horizontal impact at the retail level and may have facilitated a horizontal conspiracy among the distributors. Further, the MAP policies as implemented by the music CD industry could be considered equivalent in effect to RPM. The effectiveness of the MAP program in raising prices in the music CD market is due to the all-encompassing nature of the MAP advertising restrictions, the participation of all the distributors, the payment of an advertising subsidy, 38

and the severe penalties imposed for a MAP violation. Further, one can clearly see that the conspiracy extended beyond some high-cost retailers that wanted to protect their mark-ups and the distributors.

This case clearly shows that MAP programs can be as pernicious as RPM and that MAP policies should be reviewed by antitrust authorities to determine their legality. Additional research is required to guide the review of MAP programs. It is possible that MAP programs with less restrictive criteria could have little antitrust impact. A key question then is can certain criteria be identified that cause MAP to be efficiency-enhancing or, alternatively, what characteristics make MAP comparable to RPM and therefore illegal under U.S. antitrust laws (*United States v. Container Corporation of America*, [1969] 393 U.S. 333). MAP as practiced in the music CD industry may not result in any benefits to consumers. The MAP programs also had both vertical and horizontal aspects. For example, it could be argued (and, indeed, was alleged in the civil suit) that the distributors participated in the retailers' cartel, which can thus be considered a per se violation. As a result of MAP, the price of CDs increased considerably. The FTC claimed that prices increased by approximately \$2 per CD and that consumers paid an extra \$480 million. Nevertheless, The Federal District Court of Maine specified that it should be judged on a rule of reason basis because of the non-price nature of the vertical restraint. Since MAP policies are agreements on what prices could be advertised, not what could be charged, it is likely that the Court would have had plaintiffs satisfy the rule of reason standard. Yet MAP, when viewed from the vantage point of music CDs, appears to have the same effect as Retail Price Maintenance (RPM). 39

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