

Record labels get slapped

It's not O.K. to fix prices online, says appeals court

A RECENT RULING BY the New York Federal Appeals Court is a victory for anyone who buys music downloads. It's also a slap in the face to several major record labels who were caught price fixing.

First, some history. We have to go way back to 2002. The Apple iTunes music store won't be launched until the following year. There is a temporary void in the new world of Internet music sales. So record companies Warner, EMI and Bertelsmann (which was then independent) decide to launch an online music store called MusicNet. Separately, Sony and Universal created a similar store called Duet, later renamed Pressplay.

The stores were a bust and Pressplay lasted only one year. (MusicNet is still operating today under the name MediaNet.) The two stores were later awarded ninth place in the "25 worst tech products of all time," according to PC World Magazine.

However, when the stores were active, customers noticed something strange. Prices between the two stores were identical.

Consumers filed numerous lawsuits, alleging that the two companies colluded to maintain the same prices. (Price fixing is illegal under the Sherman Anti-Trust Act of 1890.)

The lawsuits were all consolidated and were heard by a U. S. District Court judge in New York. Consumers lost the first round. They appealed.

Seven years later after the music stores closed, the appeal was heard.

"Customers noticed something strange. Prices between the two stores were identical."

LEGAL CORNER



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And on Jan. 13, a New York Federal Appeals Court threw out the district court's ruling. The case is *Starr v. Sony BMG Music Entertainment et al*, 2010 WL 99346 (2nd Cir. 2010).

In this particular appeals process, consumers have not actually won yet, but the case now goes forward. Consumers have a good shot at victory.

DETAILS OF THE CASE

The contentions of the suit were that the defendants had all signed distribution agreements through which prices of music sold over the Internet were artificially and intentionally inflated, despite the dramatic cost reductions that Internet sales had created.

Price inflation was so dramatic that a prominent computer industry magazine concluded that "nobody in their right mind will want to use" these services.

Nonetheless since they were the only ones available, consumers had no choice. (The only other choice was iTunes, which only worked for iPods.)

Prices were maintained at an artificially high level through means of secret "most favored nations" clauses that permitted signatories to receive the benefit of more favorable terms any one of them might receive.

These agreements were purposefully kept secret because the defendants believed --rightfully so -- that they would attract anti-trust scrutiny. In fact, at the time of the suit, the defendants were being actively investigated by the Department of Justice.

Unexpectedly, despite the glaring factual support for the plaintiff's allegations of anti-trust and restraint of trade, consumers lost the first round. The U. S. District

Court for the Southern District of New York dismissed their complaint.

The district court held that the mere existence of multiple joint ventures apparently operating parallel practices did not create an inference that there was ongoing restraint of trade.

The Court of Appeals for the Second Circuit disagreed and held that the factual allegations contained in the complaint set forth more than just a parallel course of action by the defendants.

Also, the fact that the most favored nation agreements were kept secret demonstrated that there was a conspiracy to create increased sale prices despite the decrease in the cost of providing the services. This was an situation analogous to the anti-trust claims lodged against Bell Atlantic that led to the breakup of Bell Telephone in 1984.

CONSUMERS MAY BENEFIT

What does this all mean to us, you may ask? If the suit is ultimately successful, it will confirm that online record stores cannot fix prices. Back in 2002, there were hardly any online music stores. Now there are dozens. This lawsuit reminds online music stores that they can't collude to keep prices high. That's a good thing for consumers.

As for musicians, the digital music world has always been a mixed blessing. The Internet has meant greater exposure and the ability to sell your music without a middleman. But piracy can kill profits.

We don't have any magic answers and certainly the future of online music is anything but clear. However, two things are certain when it comes to music on the Internet. Price fixing is illegal. So is piracy.

VEBA'S REVISITED

Last month I wrote regarding the various methods by which union dues may be collected. In that regard, I discussed a tax exempt entity known as a VEBA, which stands for Voluntary Employees' Beneficiary Association. This is complex subject matter and more discussion is warranted regarding the creation and function of VEBA's. So here goes.

As I previously noted, a VEBA is a product of Section 501(c)(9) of the Internal Revenue Code. As with any 501(c) tax exempt entity, there are codified IRS regulations prescribing the uses and limitations of the VEBA as a tax exempt entity. The specific regulations guiding the utilization of VEBA's

is found in 26 CFR 1.501(c)(9)-3. Under these regulations, in order to be entitled to tax exempt status, a VEBA must provide for the "payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries." To the extent that the intended benefit does not fit within this definition, a VEBA would not be appropriate.

Traditionally, VEBA's have been utilized to provide either health insurance benefits -- GM and the UAW entered into such an arrangement -- or supplemental unemployment benefits to employees. In accordance with 26 CFR 1.501(c)(9)-3(d)(2), "other benefits" under this section includes any benefit that protects against a contingency that impairs or interrupts a VEBA member's earning power. Strike fund benefits or emergency relief fund benefits in ICSOM's case apparently fit within the scope of "other benefits" under this regulation. (I must note that there is no definitive regulation deciding this point.) To the extent that dues contributions fund such a benefit, which they do in ICSOM's case, a VEBA should be an appropriate mechanism for the transmission of dues.

A host of other regulations and requirements apply to the creation and maintenance of a VEBA, including the anti-discrimination requirement applicable to ERISA funds. Therefore, before a union or orchestra committee attempts to create a VEBA, they would be best served by consulting with an attorney well versed in the creation of tax exempt vehicles.

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