



▶ THE BUSINESS JOURNAL OF THE FITNESS INDUSTRY

Exclusive Showing



In specialty fitness, exclusivity contracts can make or break a store.

By Doug Schnitzspahn

It took one phone call for Greg Feeder, co-owner of AtHome Fitness, to realize the benefits of being the exclusive dealer of a well-known brand. When Feeder secured the rights in late summer 2008 to sell Life Fitness equipment in Arizona, the first person who called to inquire about the brand bought a treadmill—right over the phone, without missing a beat.

Feeder and his business partner, Bryan Dorksen, who own three specialty shops in Arizona, had drawn on their reputations and years of networking to acquire

Life Fitness when its exclusivity deal with another store ended.

“We have the power of a brand name now,” Feeder said. “Just putting ‘Life Fitness

authorized dealer’ on our website means the calls are coming in. If you google Life Fitness in the state of Arizona, we come up on top in pay-per-click.”

But that’s just the tip of the iceberg: Becoming the distributor of a larger brand gives a specialty shop the financial muscle to build itself into a reliable retailer that also carries smaller, yet high-margin brands with strong reputations. AtHome Fitness also has exclusive distribution of many of those smaller, high-end brands, meaning that if customers in the area want that

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Rethinking Your Business?

At the 2008 Health & Fitness Business Show in July, SNEWS® presented its first “State of the Industry” address to a standing-room-only luncheon crowd. Little did we know that the wavering economy in July, albeit one that was showing glimmers of hope, was going to take another downturn. At the time we said, when you are given lemons, the best thing to do is make lemonade. We may be drinking lemonade for a while considering that the economic experts, who once said they expected recovery after the election, are now forecasting that retail recovery may not happen until the second half of 2009.

That doesn't mean slamming your fists onto the big, red, panic button. What it means is managing as tightly as possible, since in every challenge there are opportunities. Perhaps this is a great time to rethink your business infrastructure, tighten up where needed, add cost-effective management tools you've been putting off, amp up customer service and follow-up, and just plain be smarter about how you conduct business.

That also means picking the right partners—both local businesses who can be synergistic with what you do (think gyms,

outdoor stores, bike stores, yoga studios, running specialty stores, personal training studios and others), as well as product vendors. As we discuss in our SNEWS eFitBiz lead story on distribution, that may mean weighing the pros and cons of being an exclusive distribution partner for a vendor and then working that relationship so it suits your retail needs best. Exclusivity, as we discuss, is far more complex than choosing a partner and then shutting out everyone else or doing only what one side demands. If operated as it should, exclusivity is a way not only to protect each other, but also to ensure high-priced items (such as fitness equipment) do indeed sell for what they're worth. But there are upsides and downsides to such an arrangement, as we present in our cover story.

Our other column, inside, looks at the copyright laws that cover the use of music in stores, waiting rooms and on the telephone. No need to get caught by surprise and be levied huge penalties. In this economy, financial surprises aren't always an opportunity.

Wishing a successful holiday season to all our readers,
Therese Iknioian and Michael Hodgson



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equipment they have to visit AtHome Fitness to find it.

This type of exclusivity is a powerful way for a specialty store to compete against big boxes, sporting goods stores and online retailers. While the arrangement may sound restrictive, exclusivity is a dynamic partnership that ensures the retailer and manufacturer can prove their worth on the open market. It's just a matter of learning how to build the right relationships.

* * *

All retail is exclusive

At its core, exclusivity is a means of maximizing sales by limiting supply and controlling prices. If you were to take a simplified look at the way relationships between retailers and manufacturers work in any business, you could say there are open systems, in which any retailer can carry a product anywhere, and closed or exclusive systems, in which manufacturers make a single retailer or retail chain the sole distributor of their products in a region.

These exclusive relationships are found most often when it comes to high-ticket items like cars, luxury items and, yes, fitness equipment. On a deeper level, though, exclusivity is far more complex than choosing a retail partner and closing everyone else out. These are agreements by which retailers and manufacturers protect each other and ensure that high-priced products sell for what they're worth on the market.

"These types of agreements have been around as long as retailing has been around," explained Daniel Butler, vice president of merchandising and retail operations for the National Retail Federation. "You can find them as far back as the early department stores of early 1900s. And exclusivity agreements are especially prevalent when it comes to luxury items. The more rare something is—or is perceived as being—the more consumers want it, and

exclusivity can drive up values. But as a retailer, you need to be able to provide a certain amount of business to make it worth a manufacturer's while."

Butler added that exclusivity could take many forms. Sometimes exclusivity is determined by the location of a store's base of operations, the placement of products in ads, and what celebrities endorse a product. He pointed to cosmetics brands like Revlon and Estee Lauder, which offer two-week promotional time periods as a form of exclusivity to control the release of its product. Brands also create so-called exclusive lines for certain retailers. At times, though, these exclusive models are simply the same as the mass distribution product except for a different model name/number and faceplate, a practice also seen in fitness. Some brands, like The Gap, are exclusive by only selling their own product, and large retail chains, like Macy's or even Dick's, have been successful at boosting the sales of their own private lines over some national brands.

"Exclusivity is just one of the many things you do in the negotiation process. A retailer is just trying to get a piece of the pie or maintain a difference in their store that makes it stand out from the other stores in the mall or across the street," Butler said.

Furthermore, exclusivity agreements don't necessarily cover all market niches. For example, Feeder of AtHome Fitness went to his local mall and wandered into a smaller mall-based boutique-like fitness, apparel and accessories store and noticed it carried some of the same products to which he thought he had exclusive rights. The difference, he said he found, was that the store was women-specific and therefore considered a separate category from his specialty fitness operation.

Accessories present the classic case for "open" distribution, although even here brands with the commonly lower-ticket items will sometimes draft exclusivity

agreements. Here, it's normally about moving a high volume of product and making it widely available, not necessarily about protecting pricing. From the manufacturer's perspective, it's all about units, so in some cases it doesn't make as much sense to limit product, although many brands remain channel-specific with different distribution arrangements. Still, that doesn't mean distributors with a more open model are not going to be careful about choosing their partners.

"We are careful about the retailers we choose to sell to since we don't want our brands in low-end stores," said Brian Anderson, president of the EB Sport Group, which targets various channels with different brands like recently acquired Valeo with a pure specialty strategy or Everlast for big box. "We might offer short-term exclusivity in exchange for a retailer's advertising or merchandising support for a new product launch but, in general, exclusive agreements are not common practice in the accessory world."

In other words, exclusivity is all about finding the right partners.

* * *

Exclusive fit

Certainly, exclusivity agreements can shut certain retailers out of a market, and you might think this discourages healthy competition and favors big players. But it can actually help small manufacturers and retailers compete against price-slashing mega-stores or e-tailers. As big retailers in all categories grow larger, amass more buying power, lower their costs, create private label brands and even source directly from Asia, it gets harder and harder for small retailers to compete, especially in a small niche like the fitness market. But when it comes to selling niche, big-ticket items like treadmills or ellipticals, exclusivity agreements can help small retailers stand out from big boxes.

"Fitness is a small industry—it's probably \$700 million at retail," said Octane Fitness President and CEO Dennis Lee, who has worked in sales in the fitness industry for the past two decades. "You're talking about a small market, expensive products and a business model in which retailers need to be able to hold higher margins to provide

"These types of agreements have been around as long as retailing has been around."

—Daniel Butler, National Retail Federation

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service and a high level of salesmanship. That's why exclusive distribution is what works for us. Exclusivity allows those things to happen."

With a dealer network of 380 stores in North America, Octane, which only produces high-end ellipticals, is distributed solely through specialty retailers. With so much riding on the success of its retail partners, Octane is extremely picky about whom it chooses as partners. Plus, while Octane makes product that garners glowing reviews from the media, it's not even close to a household name—typical of most fitness equipment brands unless they are seen in gyms and known by avid gymgoers. Many mainstream consumers have not seen or used this product in the gym, so salespeople must work hard to pitch the brand and make it seem desirable. Exclusivity therefore gives Octane a higher perceived value with customers since it is rare. Subsequently, retailers who carry the product won't get undercut by sporting goods stores or online competitors since a customer who has picked up on the buzz

and wants Octane product will have to go to an area store with exclusive distribution.

"The dealer oath is to represent that product as best as you can, to be *the* distribution for that vendor in that market," AtHome's Feeder said. "There are too many manufacturers in our industry already. The companies that have the better products sell more and have more control over the exclusivity of their products. If it were open to everyone, if everyone were selling it, you would have an attrition process. Customers wouldn't want to buy it because everyone is selling it."

If more than one dealer carries the same line in a region, everyone begins to suffer, many said they believe. The competing stores begin to wage price wars that cut into margins and it hurts the retailers and lowers the prestige of a brand. Plus, manufacturers can't set a minimum price for fear of getting in trouble with the federal government. For example, when manufacturers deal with more than one retailer in a geographic region, retailers told us a customer will go back and forth between two

stores, bargaining by claiming the "other guy will sell it for \$100 less" until a retailer either gives up on the sale or sells at an untenable margin. Most said that exclusivity in fitness ensures that retailers turn the types of margins they need to survive and continue to advocate for the smaller and higher-end brands.

That type of brand inoculation—a guarantee that a retailer can sell the brand better than anyone else—is really the key to a retailer landing an exclusive relationship. The hard part for retailers just getting started is that it is based upon reputation. It's all about the money, but it's also about ensuring long-term success.

"Even though we love our products and believe in them, expensive products—treads, bikes, ellipticals—require a higher level of salesmanship," Octane's Lee said. "When we started Octane, we laid out a map and targeted every market and then said here are the retailers we want to do business with. We wanted exclusive relationships with the best retailers in each market. It's not just how many units will

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they sell, we also want to be working with long-term viable businesses.”

So a manufacturer can boost a retailer's prestige, but the retailer usually has to live up to the deal as well. Under-perform and you lose the line—that's the mantra. Still, we have been told having exclusivity to a certain brand in an area may also help keep a retailer afloat who may not necessarily be the market's best but is willing to comply with manufacturer's demands.

“We want people committed to product lines and categories and price points,” said Kevin Lamar, vice president and general manager of Star Trac's consumer division, which covers different segments by distributing separate brands to different retail channels—for example, sporting goods stores sell the Ignite brand, while specialty stores sell high-end Star Trac machines. “Some retailers sign up and don't deliver the numbers, so it's always a bit of a balancing act,” Lamar said, noting that retailer contracts vary, and each includes goals, so the manufacturer can end the exclusive rights if a retailer fails to perform. Of course, that's also why some retailers will push some brands over others—sales goals or perhaps better spiffs.

* * *

Trust the brand

While exclusivity agreements build partnerships, they also strengthen a specialty store's reputation. People who plan to purchase high-ticket items don't necessarily want to buy at a local sporting goods chain, Wal-Mart, or shop through an online seller where they don't think they can get—or maybe won't get—reliable setup and service. If they spend a large amount of money on a machine, they'll want to have a personal relationship that a specialty dealer could provide. That's a bonus that even the best brands cannot provide on their own, and retailers rely on their customer service to build long-term relationships with customers.

“We bring sales, service, support, delivery to the table,” AtHome's Feeder said, echoing the voices of other retailers. “You can call the place you got it from, and the guy you bought it from can fill out a service form.”

Providing that level of service is the best argument a specialty retailer can make to convince a customer to buy from a local

store instead of a big chain or an online seller. Even though a customer might spend more, he or she has the comfort of buying trusted brands and working with a trusted dealer. And savvy manufacturers learn to take advantage of the best retailers to move their product. But ultimately, it's about the store, not just the brands.

“Exclusivity ties directly into your brand strategy and marketing strategy. It's about the future, not just today, but looking down the road, three, five, seven years and thinking about where you want to be,” said Butler, of the National Retail Federation.

And AtHome Fitness' Feeder admitted the success he has had in landing brands like Life Fitness and Octane is just the beginning. He and others realize that their store's brand is the truly long-lasting one.

“I would play down exclusivity as more of

a partnership really,” he said. “It gives you staying power. But it's really not in my best interest long term to rely on manufacturer brand names. We need to develop into a brand within a brand. Long term, we want people not to just trust the brand names we carry but to trust AtHome Fitness.”

So as long as there are manufacturers willing to support specialty retailers, those who can rise to the top can survive; if not, the system will change.

“It works. And if exclusivity is not the right thing for the market, it will change,” Octane's Lee said. “That's the beautiful thing about capitalism.”

See additional sidebars on pages 6 and 7.

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Tip-top Shape

Five tips to building successful exclusivity agreements.

1. Network. Successful relationships between dealers and manufacturers often come about because both parties have known each other, sometimes for years. “This is a very, very small industry. It still runs in some ways like a mom-and-pop operation. Everybody knows everybody,” said Greg Feeder of AtHome Fitness.

That familiarity creates an element of trust. “If manufacturers trust you, they know that in the end they are better off having a dealer who supports them instead of one who can make more money and lowballs,” said Greg Feeder of AtHome Fitness.

And always remember just how small an industry it is. “I've been in the industry 21 years and can tell you that you should never burn a bridge, because you may not be doing business with someone today, but three or four years down the line, you just may be. It's a good philosophy as a human being and a great philosophy as a businessperson,” noted Dennis Lee of Octane Fitness.

2. Communicate. Good business relationships depend upon open communication. A dealer and manufacturer should share their goals from day one to eliminate any possible surprises down the road. According to Octane's Lee, you should cultivate those relationships even when you are not doing business. “I just talked to a retailer today. We have never done business together, but we talk every six months.” Lee also suggested that retailers share their business plan with manufacturers. “It's really a great way to make sure the manufacturer knows where you are going. You may not be there today,

but manufacturers are trying to plan too. If the communication is open, both parties can share goals in the future,” he said. AtHome Fitness was not an Octane dealer when it opened in 2004, but Feeder kept the lines of communication open with Lee, until the time was right.

3. Find the right partner. Not all shops and brands were meant to go together. “It has to be a good fit,” said Feeder. “You don't have Ford and Chevy on the same lot.” The right fit means more than the synergy between store brand and product brand. Look at your customer base and be smart about which lines you want to carry simultaneously. And pick partners you enjoy doing business with.

4. Over deliver. Exclusivity arrangements are about maximizing dollars. A manufacturer helps a retailer by protecting the line and prices, while a retailer holds up his end by meeting sales targets necessary for the manufacturer to succeed. “Make sure you can deliver on your side of the bargain,” said Kevin Lamar of Star Trac. “Otherwise, things go sideways in a hurry.” In fact, Lamar noted that the most successful retailers over deliver on their commitments.

5. Talk to your lawyer. Daniel Butler of the National Retail Federation suggested that you talk to a lawyer when you are negotiating any distribution contract. “You need to understand what the contract really says and make sure it's something you want to live by. What are the grounds for ending the contract? What is the exit clause?”

Putting Your Best Brand Forward

How to best represent exclusive brands on the sales floor.

Educate

There's minimal brand-name recognition in home fitness. Your customers may have heard of Precor or Life Fitness from the gym, but it's unlikely they've heard of Landice or Octane or know the difference between Torque and Vectra. And, many don't really care. It's up to your sales staff to educate consumers on the strengths of each brand and to listen to them so they find the product that matches their needs.

Some manufacturing partners will provide training that keeps your sales force educated and helps them sell more. Octane Fitness conducts training four times every year with its "A" column dealers. "Now we have someone ready to tell the Octane story," said Dennis Lee. "The better we tell that story, the more customers become Octane disciples, telling everyone about their new workout. The people who are using our product are the best marketing tools we have."

Be special

Specialty retail has one enormous advantage over the big-box stores and online retailers: service. Leverage your ability to deliver, service and troubleshoot the products you sell, and

even the ones you don't. "Customers count on us to be their problem solvers for each market," said Greg Feeder of AtHome Fitness. Sure, they may be able to find a cheaper piece of equipment, but that's all they get. Plus, while providing these services may cost specialty retailers, these services are an investment in the long-term future of their businesses since they encourage customers to return and create a good word-of-mouth buzz for the store.

"Follow the customer"

So said Rich Hill, a retail vet, who has since held executive positions at outdoor brands like Kelty, Patagonia and Ibex and currently consults for Amazon.com. Hill asserted that online stores like Amazon do not take away business from specialty retailers since they are not targeted at the same customers. The whole point of exclusivity contracts is to sell at higher price points and to add value to a product that can't be found anywhere else.

In other words, know what type of customer is interested in your store and your brands and cater to that customer base. If you want to expand the retail channels in which you operate, try moving into Internet sales to move inventory at lower prices and reach different



customers—depending on what the contract with your partner allows.

Be flexible...to a point

Exclusivity provides price protection, but customers often want to find the best deal they can. Feeder has had customers call in and tell him they have seen one of his exclusive products outside the state of Arizona for less. If it makes sense and leads to an immediate sale, drop the price—but only do so if it will help you reach the sales goals you have set with your manufacturer. Don't undercut yourself.

Accessorize

It's an old retail mantra, but make the small sales alongside the big sales. According to Brian Anderson of EB Sport Group, "All of this equipment is for home use, and no matter what equipment you sell, there are plenty of accessories perfect for home use. Always put them out there. If you don't ask, you don't get." **S**

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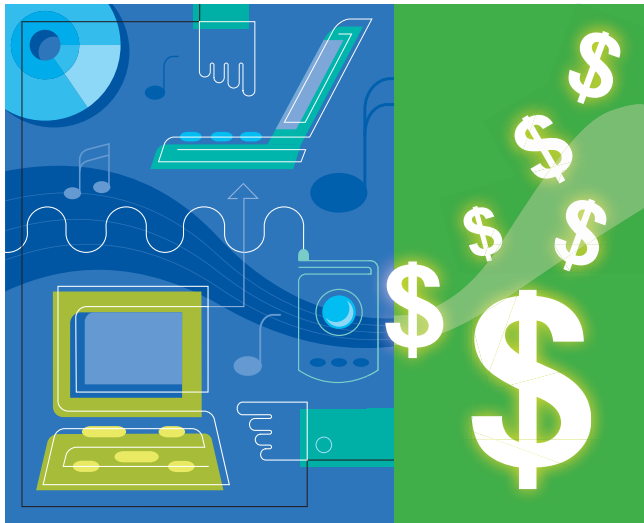
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And the Beat Goes On

What does it cost to play music in a retail store? More than you might think. By James Moss

In 1999, Congress passed the Fairness in Music Licensing Act of 1998, modifying the U.S. copyright laws—the basis for which musicians, authors and artists receive payment for their work.

The copyright law also protects the creator of the work and provides a way for authors, musicians or artists to stop the theft of their work and recover damages for the theft.

What does this have to do with a fitness equipment store? Based on your store size, you may owe fees for playing music in your store. That covers any music played over your sound system using purchased CDs, downloaded music or the local radio station. And, it includes videos that you may show on TVs, which are covered in another section of the law.

> Ground rules

What exactly does that mean? The best place to start is how we pay for music in the United States. When musicians or bands create songs or pieces that will be played commercially, they sign with a collection agency. The agencies represent the musicians and collect the fees whenever their music is played. Musicians are also paid by selling their songs on the web or on a CD.

The collection agencies license different businesses or venues, allowing them to play the music, and then they collect the money and pass it on to the musicians. Most of the agency's time is spent licensing establishments and businesses, which allows them to play music for a monthly fee. If you are not licensed or do not pay your fees, you receive a demand letter. If you ignore that, expect a lawsuit. The collection agency finds violators by scouring the country, and by receiving tips from angry customers, musicians or competitors.

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The problem people run into is they do not understand what they own when they buy a CD or download songs. When people purchase a CD, they are buying the right to play the music for themselves and their friends. Buying the CD does not buy the music; you are buying a piece of plastic and a license, which is very restrictive in how it can be played. Sheet music purchased can be played for a small gathering, not for profit of the person playing it. You cannot, however, make money or use the music to enhance your opportunity to make money since you effectively bought a personal license. A license for a commercial establishment is different. Those are purchased from the collection agencies. If you violate your license, you can be sued.

You are not sued for breach of contract with the musician; you are sued for violation of the federal copyright law. Damages can reach \$30,000 per song played without a license, plus costs and attorney fees. If you do not qualify for an exemption from the copyright law, then you should get a license or find a music source that does

not require a license because the copyright has expired.

Winning the fight is next to impossible. Copyright laws are federal regulations, initially described in our constitution and have been upheld continuously. The fees charged by collection agencies have also been upheld by the courts as fair and reasonable.

> Retail ramifications

How does this affect a retail establishment? Anyplace where music is played by someone for someone, the person playing the music owes money to the musician. Bars, restaurants, radio stations, health clubs, lobbies, retail establishments and the hold music on your telephone all must be licensed.

While the Fairness in Music License Act is fairly extensive, there are a few exemptions that allow retailers to play music in their store without paying a fee:

- Stores of less than 2,000 square feet and using less than six speakers, with no more than four speakers in one room, can play radio stations or CDs for free and without obtaining a license. The only stipulation is the music must be played for free, i.e., no

charge for admittance.

- If you serve food, then the exception applies to up to 3,750 square feet.
- If you sell music and are playing the music to entice people to buy the music, you are not liable.

But, wait, it still may not be that easy. The collection agencies are serious about their duties, and any issue will be litigated by them. Some collection agencies charge based on number of speakers, while others charge by square footage. Your square footage includes every space you own or lease except customer parking. Measuring inside walls may not keep you safe; refer to your lease to determine the size of your store.

Also, you cannot use this exemption if you have more than six locations or your shares are publicly traded.

If you are close to the limits or do not fit into the exemption, you should consult with an attorney. He or she can provide the correct information and help you obtain a license if warranted. **S**

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