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Competition Issues related to E-Books

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Introduction

The advent of e-book publishing revolutionized the literary publishing world, but also brought about significant changes in the distribution and pricing models, which may not be in conformity with competition law and are, thus, under scrutiny by competition authorities. Moreover, the existence of multiple e-book formats may hinder competition and could be seen as an abuse of dominant market position; this is due to the fact that they raise platform compatibility issues and, also, that they are tied to proprietary reader technology.¹

An electronic book, shortly e-book, is basically a digital file that contains text and icons, which is distributed over the Internet, but can be read offline on a computer and other electronic devices, mainly dedicated e-book readers. E-books are the electronic equivalent of print versions, but may also be originally produced in digital format, i.e., 'born digital'.ⁱⁱ Their advantage over traditional print books is that they become more accessible and easily traceable.ⁱⁱⁱ They are also less costly, while modern technology provides the ability of a conceivable number of e-books and journals to be stored on a device.^{iv}

E-books were introduced in the early 1990's, but they did not make any success until new devices were developed that provided ease of use.^v Notably, the Amazon's Kindle, Sony's PRS-500 and Barnes & Noble Nook were the most successful devices, while a certain breakthrough came with the advent of Apple iPad and Apple's iBookstore.^{vi} As of 2010, the sale of e-books began to grow exponentially and on May 19, 2011 Amazon announced that it has sold more e-books than hardcover and paperback print books combined.^{vii} This development is indicative of the effect that digitization has on the publishing industry, which undergoes a transformation similar to those already taken place with regard to the music and entertainment industry.^{viii} E-book publishing becomes a trend of future advance and the new landscape of digital publishing has the potential to change not only the way people assimilate information, but also the way of reading, whether for work or for pleasure.^{ix}

From the Wholesale Distribution Model to the Agency Distribution Model

The transformation of the publishing sector is associated with the change of the distribution model. Under the traditional wholesale model for books, publishers set a recommended retail price, which is half the price of the print edition, and give the seller the freedom to control the final price, offering discounts at their discretion.^x A radically different approach is adopted, however, with regard to e-books.

In more particular, in January 2010 Apple announced that it had agreements with five of the six largest publishing houses to provide e-book content for the iPad, who were based on an agency model that gives publishers the ability to set e-book prices, while Apple receives a commission of 30 percent from each e-book sale through Apple's online bookstore. This implies that publishers have the ability to set e-book prices by their own, while Apple become a distribution agent for sales to consumers.^{xi} Under this agreement, e-book prices are tied to the list prices of comparable print editions and thus, e-book prices would vary in a range from \$ 12.99 to \$ 14.99 for most general fiction and nonfiction titles.^{xii} Publishers of e-books are also required to ensure that the prices of e-book offered through the iBookstore are not higher than the prices at which they are offered from other e-book distributors (so-called 'most favored nation' clause).^{xiii}

Amazon, on the other hand, has set a low price for new releases of e-books (\$9,99) in order to give a boost to their sales, but that model was opposed by publishers, which worried that these discounts could lead to cannibalization of hardcover sales and lead to expectations of consumers of low prices for all books. Publishers preferred the agency model suggested by Apple, as it gave them higher prices than those offered by

Amazon. Consequently, Amazon was forced to enter into negotiations with book publishers and also accept the agency model.^{xiv}

Legal review of price fixing and the agency distribution model for e-books

The pricing models adopted for e-books are not without consequences for the competition on the market. This is elucidated by the fact that e-book publishers' practices are under investigation on both sides of the Atlantic. In particular, in March 2011 the European Commission carried out unannounced inspections at the premises of companies that are active in the e-book publishing sector in many EU Member States and on December 6, 2011, decided to open an investigation into Apple and five major book publishers (Hachette Livre, Harper Collins, Simon & Shuster, Penguin, and Holzbrink, the German parent of Macmillan).^{xv} The Commission had reason to believe that the companies concerned may have violated EU antitrust rules that prohibit cartels and other restrictive business practices, according to Art. 101 of the Treaty on the Functioning of the European Union (TFEU).

The US Department of Justice has also initiated legal proceedings on April 13, 2012 against Apple and certain e-book publishers, alleging that the companies have violated US antitrust laws by agreeing to fix the price of electronic books. Likewise, 16 U.S. States have filed a lawsuit in a district court in Texas against Apple and certain publishing companies, alleging that they have acted anti-competitively by fixing e-book prices.^{xvi}

Under EU law, a prohibition of price fixing is established by virtue of Article 101 (1) of the Treaty on the functioning of the European Union, stating that “the following

shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which: (a) directly or indirectly fix purchase or selling prices or any other trading conditions; (...)"

The jurisprudence of the CJEU is clear that a provision setting out minimum retail prices to be charged by distributors has as its object the restriction of competition.^{xvii} So, e.g., in *Pronuptia v. Schillgalis* the CJEU provided guidelines on the compatibility of distribution franchises with Article 101 (1). It thereby held that 'provision which impair the franchisee's freedom to determine his own prices are restrictive of competition'. Also, in *SA Binon & Cie v SA Agence et messageries de la presse* the Court held that 'provisions which fix the prices to be observed in contracts with third parties constitute, of themselves, a restriction of competition within the meaning of Article 101 (1) which refers to agreements which fix selling prices as an example of an agreement prohibited by the Treaty'.^{xviii}

In accordance with this jurisprudence, agreements between suppliers and distributors that provide for fixing minimum prices to be charged by distributors would be regarded as restricting competition.^{xix} However, it is accepted for a supplier to provide dealers with price-guidelines, so long as there is no concerted practice for the actual application of the prices.^{xx} The CJEU also held in *AEG-Telefunken v. Commission* that the provision of price guidelines or the operation of a selective distribution system might be compatible with Article 101 (1) so long as it is not operated in a way

that precludes price discounting.^{xxi} Moreover, the Commission has taken strong action against resale price management and imposed sanctions for fixing resale prices.^{xxii}

It is notable that Regulation 330/2010 of April 2010 provides in Article 2 for an exemption of Article 101 (1) TFEU as regards vertical agreements, in so far as such agreements contain vertical restraints. This provision applies to vertical agreements relating to the assignment of intellectual property rights and thus, it is relevant in case of e-books. However, under Article 4 of the Regulation, the benefit of the block exemption in Article 2 does not apply “to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object: (a) the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties (...)”.

With the enactment of Regulation 330/2010 the European legislator acknowledges that certain types of vertical agreements can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings. Nevertheless, resale price management is regarded as a «hardcore» restriction of competition that is objectively illegal and cannot benefit from the exemption.^{xxiii}

As a result, the imposition of specific ranges of e-book prices by Amazon and Apple can be seen clearly as an infringement of Article 101 (1) TFEU. It has been mentioned above that Apple included in the ‘agency distribution’ agreements a clause that ties the price of e-books to prices of comparable print editions, which results into prices

ranging from \$ 12.99 to \$14.99, while Amazon has set \$9.99 as the default price for most new edition of e-books. The same can be said for the requirement set forth by Apple in the ‘agency distribution’ agreement “that publishers not permit other retailers to sell any e-books for less than what is listed in the iBookstore” (‘most favored nation clause’). Such agreements restrict competition between the parties on the supply side and limit the choice of purchasers and thus, fall under Article 101 (1) TFEU.^{xxiv}

Furthermore, the ‘agency price model’ introduced by Apple could be regarded as a vertical restraint falling under the prohibition of this provision for the reason that it limits the freedom of retailers to determine the final price of e-books, since the prices are essentially fixed by publishing companies.

It is left to see whether the e-book agency agreement falls within the prohibition by Article 101 (1) or not. In case the reseller is regarded as an agent, there is no agreement between undertakings and Article 101 (1) TFEU does not apply. For a reseller to be qualified as an agent, according to CJEU jurisprudence and the Guidelines on Vertical Restraints of the EU Commission^{xxv}, it is crucial to establish whether it operates as: i) an ‘auxiliary organ’ forming an integral part of the principal’s undertaking^{xxvi}; or ii) an independent economic operator assuming financial and commercial risks linked to sale or the performance of contracts entered into with third parties so that the agreement is subject to Article 101 (1).^{xxvii}

In our view, the agency agreement between e-book publishers and resellers such as Apple seems to fall within the ambit of Article 101 (1) TFEU, as any other vertical agreement, since operators acting as agents do not form an integral part of the business of the former and they also do not assume apparently any financial and

commercial risks linked to the sale or the performance of contracts entered into by the latter with consumers.

Moreover, the selling of books at a fixed price may be seen as contravening Article 28 TFEU. In case *Fachverband der Buch- und Medienwirtschaft v. LIBRO Handelsgesellschaft mbH* the CJEU established that the prohibition on importers of German-language books from fixing a price below the retail price fixed or recommended by the publisher in the State of publication constitutes a restriction on the free movement of goods which cannot be justified.^{xxviii} In this case, the Austrian law provided that the publisher or importer is under an obligation to fix and publish a retail price and the importer is not to fix a price below that one. The Court established that ‘such provisions are to be regarded as a measure having equivalent effect to an import restriction contrary to Article 28 EC, in so far as they create, from imported books, a distinct regulation which has the effect of treating products from other Member States less favourably’.

It is notable that the price of e-books has been regulated explicitly in France, where Act No. 2011-590 of 26 May 2011 on the price of digital books (Loi n° 2011-590 du 26 mai 2011 relative au prix du livre numérique) was established. The objective of this act is to allow e-book publishers to maintain control over the price of e-books in order to assure the promotion of the cultural and linguistic diversity.^{xxix} It provides in Article 2 that any person established in France, which publishes a digital book for commercial distribution in France is required to set the price for sale to the public concerning any type of offer and this price has to be announced to the public. The selling price may differ depending on the content of the offer or the modality of access or use. Thus, it may not be in conformity with this Law to establish minimum

sale prices for e-books, however, there is no conflict with the agency agreement, introduced by Apple. So, there is still a need to implement competition rules in the agency distribution model.

In the U.S., the early jurisprudence of the Supreme Court found that retail price management is a per se violation of section of the Sherman Act.^{xxx} However, the Supreme Court later revised its position and stated that vertical price restraints such as minimum and maximum resale price management had to be judged by the rule of reason, i.e. after a complete analysis of the effects of such practice on the market.^{xxxi} Thus, such practices could be regarded as permissible under federal antitrust law.

Moreover, since the *General Electric* Decision^{xxxii}, the jurisprudence of lower courts in the U.S. found no liability under antitrust legislation in case of an agreement, in which an intellectual property owner only licenses its rights to another party or distributor and limits or specifies the price of a sublicense. This might be the case also for e-books, since the object of transactions between e-book publishers and online retailers is a license and not the sale of hard copies.^{xxxiii}

Consequently, the agency distribution model and also the ‘most favored nation’ clauses included in the agency agreement would be both subject to a rule of reason analysis, and the outcome of the case seems uncertain.

Antitrust Issues concerning tying of e-books to branded formats

A particular issue of concern is that there exist different formats of e-books and some formats are compatible only with their branded format. So, e.g., Kindle e-books can

be read on Kindle devices or on other platforms, depending on the agreements made by Amazon with other providers.^{xxxiv} There is a certain tie of hardware to content of digital books and a lack of common standards, which both may compromise the rights of e-book consumers. This tie to reading devices, the raise of new intermediaries, and the increased value of comprehensive book collections are seen as a major problem for competition and openness of information markets.^{xxxv}

Under EU law of competition, the practice of a competitor who may try to foreclose its competitors by tying may constitute an abuse of dominant position.^{xxxvi} Generally, there is a case of “tying” that can constitute an abuse under Article 102 TFEU when pursued by an undertaking in a dominant position, where customers that purchase one product (the tying product) are required also to purchase another product from the dominant undertaking (the tied product). In the situation where certain e-book formats are compatible with e-book readers offered only by providers of certain e-book stores, it appears to be a case of technical tying. Notably, a case of technical tying occurs when the tying product is designed in such a way that it only works properly with the tied product (and not with the alternatives offered by competitors).^{xxxvii}

A similar situation occurred in the case where Microsoft made available the Windows client PC operating system conditional on the simultaneous acquisition of the Windows Media Player (WMP) software. The Commission found that Microsoft had infringed Article 102 TFEU (former 82 EC), as it abused its market power by tying its WMP with its Windows operating system.^{xxxviii} Consequently, Microsoft filed an application for the annulment of the Commission’s decision, but the Court of First Instance of the EC rejected the claims relating to the annulment of the contested decision.^{xxxix} In its decision, the Court found that the tying of the two software

products led to the foreclosure of competing media players from the market and thus, it had anticompetitive effects that cannot be offset by the uniform presence of media functionality in Windows, as supported by Microsoft, which pointed out that software developers and Internet site creators avoided the need to include in their products mechanisms which make it possible to ascertain what media player is present on a particular client PC. Microsoft also claimed that the integration of WMP in Windows led to the de facto standardization of the WMP platform, which had beneficial effects on the market. This argument was rejected by the Court, which held that generally, standardization may effectively present certain advantages, but it cannot be allowed to be imposed unilaterally by an undertaking in a dominant position by means of tying and also, because third parties may not want such a de facto standardization.

For the provision of Article 102 TEAFU to apply in e-books, it has to be established whether the undertaking is dominant in the tying product market, but not necessarily in the tied market.^{x1} Additionally, the following conditions must be fulfilled: (i) the tying and tied products must be distinct products, (ii) the undertaking concerned does not give customers a choice to obtain the tying product without the tied product; and (iii) the practice in question forecloses competition.^{xii} In particular, it has to be investigated whether an operator of a web store offering e-books enjoys a dominant position in the market for e-books and it offers books that can only be read by e-book reading devices manufactured by the same company. Such an investigation has not been initiated by national competition authorities or by the EU Commission, but it remains a possibility.

Conclusion

It has been shown in the previous analysis that in the market for digital works new exploitation and distribution models are introduced that might be more suitable for the proliferation of new digital assets such as e-books. However, the changes that take place are not always compatible with antitrust legislation and particularly, clauses in distribution agreements that limit the freedom of distributors and limit competition might be found to infringe anti-trust legislation. In addition, the tying of e-book format to specific hardware might also be regarded as infringing in case certain requirements are fulfilled.

ⁱ Seringhaus, “E-Book Transactions: Amazon “Kindles” the Copy Ownership Debate”, *Yale Journal of Law and Technology Fall, 2009-2010*, 147.

ⁱⁱ Elkin-Koren, “The Changing Nature of Books and the Uneasy Case for Copyright », *George Washington Law Review, Sept. 2011*, at 1715.

ⁱⁱⁱ Electronic Frontier Foundation, Digital Books and Your Rights: A Checklist for Readers. Online available at: <https://www.eff.org/wp/digital-books-and-your-rights>

^{iv} A. Stoeppelwerth, “Antitrust Issues Associated with the Sale of E-Books and other Digital Content”, *Antitrust, Vol. 25*, Number 2, 69.

^v B. Pimm, “Riding the Bullet to the Ebook Revolution”, *18 Ent. & Sports Law* (Summer 2000), 1.

^{vi} Stoepfelwerth, *Antitrust Issues*, 69.

^{vii} M. Scott, “E-Books on a Roll; Paper Books in Trouble”, *Cyberspace Lawyer*, (November 2011), Vol. 16, Issue 10, 3.

^{viii} Elkin-Koren, *The Changing Nature of Books*, 1713; N. Vermylen, “Book Publishing in the Age of the E-Book”, *Vanderbilt Journal of Entertainment Law & Practice* (Spring, 2002), 191.

^{ix} C. Nguyen, “A Modern Library Class Action: The Google Book settlement and the Future of Digital Books”, *Hastings Communications and Entertainment Law Journal*, Winter 2011, 257.

^x D. Marron, “How Should we Price E-Books. Does the agency pricing model in the e-book industry limiting competition and thus harming consumers?”, *Christian Sci. Monitor* (Aug. 23, 2010), online available at:

<http://www.csmonitor.com/Business/Donald-Marron/2010/0805/How-should-we-price-e-books>

^{xi} Stoepfelwerth, *ibid.*

^{xii} M. Rich, “Apple’s Prices for E-Books May Be Lower Than Expected”, *The N.Y. Times*, Febr. 17, 2010.

^{xiii} Rich, *ibid.*; Stoepfelwerth, *ibid.*

^{xiv} Stoeppelwerth, *ibid.*

^{xv} See MEMO/11/126, Brussels, 2 March 2011.

^{xvi} See <http://www.out-law.com/en/articles/2012/april/apple-and-e-books-publishers-accused-of-price-fixing-conspiracy-by-us-government-in-lawsuit/>

^{xvii} A. Jones & B. Sufrin, *EU Competition Law. Text, Cases and Materials*, 2010, 656

^{xviii} Case 243/83.

^{xix} A. Jones & B. Sufrin, *EU Competition Law*, 657.

^{xx} CJEU, Case 161/84.

^{xxi} Case 107/82, *AEG-Telefunken v. Commission*.

^{xxii} A. Jones & B. Sufrin, *EU Competition Law*, *ibid.*

^{xxiii} Vardela, *Competition in the e-books sector: rough riders! Antitrust & Technology*

23 décembre 2011, online available at:

<http://vardela.unblog.fr/2011/12/23/competition-in-the-e-books-sector-rough-riders/>

^{xxiv} A. Jones & B. Sufrin, *EU Competition Law*, 1015 et seq.

^{xxv} OJ C 130/10.

^{xxvi} See Case 311/85, *ASBL Verenging van Vlaamse Reisbureaus v. ASBL Sociale Diense van de Plaatselijke en Gewestelijke Overheidsdiensten*, paras. 19-20; Case C-266/93, *Bundeskartellamt v. Volkswagen AG and VAG Leasing GmbH*, para. 19; Case C-217/05, *Confederacion Espanola de Empresarios de Estaciones de Servicio v*

Compania Espanola de Petroleos, paras. 38-63s; Case C-279/06, *CEPSA Estaciones de Servicio SA v LV Tobar e Hojos SI*, paras. 33-44.

^{xxvii} Guidelines, para. 21; A. Jones & B. Sufrin, *EU Competition Law*, 634.

^{xxviii} Case C-531/07.

^{xxix} B. Kerjean, « Loi sur le prix du livre numérique. Vers une nouvelle exception culturelle française », *Communication – Commerce Electronique – Revue Mensuelle Lexis Nexis Jurisclasseur* (Septembre 2011), 9.

^{xxx} *Dr. Miles Medical Co. V. John D. Park & Sons Co.*, 220 U.S. 373 (1911); *Albrecht v. Herald Co.*, 390 U.S. 145, 152-54 (1968); Stoepelwerth, 70.

^{xxxi} *Leegin Creative Leather Products v. PSKS*, 551 U.S. 877 (2007); *State Oil Co. V. Khan*, 522 U.S. 3 (1997).

^{xxxii} *United States v. Gen. Elec.*, 272 U.S. 476 (1926).

^{xxxiii} Stoepelwerth, *ibid.*

^{xxxiv} Elkin-Koren, *The Changing Nature of Books*, 1739 et seq.

^{xxxv} Elkin-Koren, *ibid.*

^{xxxvi} A. Jones & B. Sufrin, *EU Competition Law*, 454 et seq.

^{xxxvii} Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings (2009), OJ C 45/2, para. 48, n. 2.

^{xxxviii} Commission Decision 2007/53/EC of 24 March 2004 relating to a proceeding under Article 82 of the EC Treaty, Case COMP/C-3/37.792 - Microsoft.

^{xxxix} Case T-201/04, Microsoft v. Commission.

^{xl} A. Jones & B. Sufrin, *EU Competition Law*, 455.

^{xli} See Guidance Paper, para. 50; Case T-201/04, paras. 842, 850 to 862 and 869.