The E-books case

Dansk Forening for Konkurrenceret
18. april 2013

Svend Albæk
European Commission
DG Competition
Chief Economist Team
Disclaimer

The views expressed in this presentation are personal, and do not necessarily represent those of DG Competition or of the European Commission.
The e-books market
• 2007: Amazon launches the Kindle and its Kindle Store in the US
  • Publishers start digitalizing their catalogue of titles
  • Other competitors enter (e.g. Barnes & Noble in US in late 2009, Apple in 2010 in US and EU)
  • Amazon starts selling in the EU as of 2009
  • In July 2010 Amazon announced that it sells more e-books than print books in the US

• In the EU fastest development of e-book sales in the UK (but other Member States (e.g. DE, FR) following)
  → 2007: EUR 1.5 million
  → 2011: EUR 111.7 million
  → 2012: EUR 308 million (estimated)
Recent developments

- Authors engage in self-publishing (J.K. Rowling)
- Authors’ agents offer publishing services
- Retailers such as Amazon offer publishing services
- New publishers only publishing e-books
- Online sales of both print books and e-books have grown significantly – high street retailers suffered

→ Traditional publishing landscape is changing
The e-books case: some facts

- About sale of e-books through competing platforms: Amazon (Kindle) and Apple (iPad) (and others)
- Amazon starts discounting e-books – bestsellers sold at USD 9.99
- Publishers had concerns about the “9.99 policy” and that low retail prices would spread to other countries, including in the EEA
More facts

- 2008 and 2009: Publishers made several unsuccessful attempts to overcome Amazon's retail prices (increasing wholesale prices, JVs)
- December 2009: Publishers think about collectively “windowing” e-books, but then...
- December 2009: Apple approached the publishers with its plans to launch the iBookstore together with its iPad in early 2010
Even more facts (III)

- The publishers and Apple agreed to switch, on a global basis, the entire industry and most notably Amazon to the agency model
  → The publishers could control (and raise) retail prices themselves

- Agency agreements signed in US in January 2010 with Apple and in March 2010 with Amazon (iBookstore launched on 1 April 2010)

- Agency agreements signed in EEA as of May 2010 with Apple and later with Amazon (iBookstore launched 28 May)
US DoJ sues Apple and some of the publishers in April 2012

**CNET News: DOJ announces suit against Apple**

At a press conference in Washington, D.C., Attorney General Eric Holder and Assistant Attorney General for the Antitrust Division Sharis Pozen announce the government's lawsuit against Apple and publishers for allegedly conspiring to increase prices.
DG COMP opens proceedings in Dec 2011

FINANCIAL TIMES

December 6, 2011 6:09 pm

EU probes digital groups over e-books’ price

By Alex Barker in London and Andrew Edgediffe-Johnson in New York

Europe’s competition watchdog is investigating whether US technology group Apple helped five publishers collude in changing the business model for electronic books in a manner that illegally raised prices for consumers.

The probe, revealed by the European Commission on Tuesday, will concentrate on a ground-breaking 2010 deal with Apple to distribute e-books on the iPad that handed more power on pricing from digital retailers to publishers.

Apple remade the business model for the industry by signing up to a so-called agency agreement, in which publishers have more control over the price at which agency books are sold. Previously, publishers set wholesale prices while retailers decided what price to charge consumers.

Amazon, the market leader in ebooks that initially resisted the change to its business model for electronic book sales, ultimately followed Apple in adopting the agency model.

The Commission investigation targets five digital publishers: Penguin, which like the Financial Times is owned by Pearson; HarperCollins, which is owned by News Corp; Hachette Livre, a part of France’s Lagardère Publishing; Simon & Schuster of CBS; and Holtzbrinck of Germany, which owns Macmillan.
...receives settlement offers in April 2012

EC receives e-books settlement offer from Apple, four publishers
11 Apr 12 | 17:14 GMT
Author: Lewis Crofts and Ana Rita Rego

IN BRIEF
EU antitrust chief Joaquin Almunia has received offers to settle an antitrust investigation into e-books from Apple, Simon & Schuster, HarperCollins, Hachette Livre and Verlagsgruppe Georg von Holtzbrinck. Today, the US Department of Justice settled its case against three publishers, while suing Apple, Macmillan and Penguin.

Brussels - EU antitrust chief Joaquin Almunia has received offers to settle an antitrust investigation into e-books from Apple, Simon & Schuster, HarperCollins, Hachette Livre and Verlagsgruppe Georg von Holtzbrinck. Today, the US Department of Justice settled its case against three publishers, while suing Apple, Macmillan and Penguin.

Almunia said he welcomed the proposals from the five companies to "reach an early resolution of the case, so promptly after we opened proceedings in December 2011."

"We are currently engaged in fruitful discussions with them, without prejudice to the outcome of these talks," Almunia said.

"We will assess any final proposals of commitments and we will test them with third parties in order to check whether they are sufficient to preserve competition for the benefit of consumers in this fast-growing market."
Case hits the press worldwide

FINANCIAL TIMES

Publishers sued over ebook price ‘collusion’

DoJ alleges Apple model hurt consumers
Apple accused by US of colluding with publishers to fix price of ebooks
Lawsuit filed by US department of justice claims Apple ended price competition after seeing success of Amazon’s $10 ebooks

Brian Braiker
guardian.co.uk, Wednesday 11 April 2012 16:50 BST

THE WALL STREET JOURNAL
WSJ.com
April 11, 2012, 12:01 PM ET
Key Excerpts from the Antitrust Lawsuit against Apple, Publishers

Here are the basics: The Justice Department alleges that Apple and several publishers — Simon & Schuster, HarperCollins, Hachette, Penguin Group (USA) and Macmillan — conspired to limit competition for the pricing of e-books.

Three of the publishers have agreed to settle, according to court documents — Hachette Book Group, Simon & Schuster and HarperCollins. Under the settlement, those publishers will terminate any agreement they have with Apple regarding electronic books. HarperCollins is owned by News Corp., as is The Wall Street Journal.

US sues Apple and publishers over e-book prices

Technology giant Apple and major book publishers are being sued by the US Department of Justice over the pricing of e-books.
Ebook suit may shift power back to Amazon

By Andrew Edgecliffe-Johnson, Barney Jopson and David Gelles in New York

After a 36-page Department of Justice lawsuit, filled with novelistic allegations of secret meetings in expensive restaurants and glimpses into the private correspondence between the Apple founder Steve Jobs and other company executives, Amazon.com had just one bland sentence to add to the thriller.

“This is a big win for Kindle owners, and we look forward to being allowed to lower prices on more Kindle books,” the Seattle-based etailer said.

Pricing of ebooks presents novel dilemma

By Andrew Edgecliffe-Johnson in New York

It was a script publishers should have been fighting each other to print. A 36-page lawsuit from the US Department of Justice this week told a tale of conspiracy, cooked up by the leaders of a high-profile industry over dinners in expensive New York restaurants such as Picholine and Alto.

The government lawyers laid out a compelling story of a battle between anxious suppliers and a powerful retailer over who should control what the consumer pays. Better still, the late Steve Jobs, co-founder of the world’s most valuable company, had a starring role.
The plot: main characters

Amazon
- Largest e-retailer, accounting for majority of e-book sales
- Developed dedicated e-book reader (Kindle)

The “Agency 5” Publishers
- Hachette Livre (Lagardère)
- Harper Collins (News Corp)
- Simon & Schuster (CBS)
- Macmillan (Holtzbrinck)
- Penguin (Pearson)
- Jointly account for significant share of overall book sales (US)
  - Random House only followed the switch to agency later

Apple
- New entrant in early 2010, with multi-purpose tablet (iPad)
Timeline 2009-2010

- Publishers express unhappiness on Amazon price policy (Dec 2009)
- Windowing by 4 publishers
- Showdown Amazon-Macmillan (late Jan/early Feb)
- Amazon accepts switch to agency in US (Feb-May)
- Apple EC contracts signed (May-August)
- Amazon accepts agency in EC (Oct-Nov)

**Wholesale** model: retailers set the price

**Agency** model: publishers set the price (RPM)

Jan 27 2010: iPad launch
2008-2009 contacts between publishers

- From September 2008: "meetings between publishers in private dining rooms of upscale Manhattan restaurants to discuss business and competitive matters, including Amazon's e-book retailing practices"

- "Meetings provide publishers the opportunity to discuss how collectively they could solve ‘the $9.99 problem’"

- Discussions on joint venture plan during 2009:
  - "The goal is less to compete with Amazon, as to force it to accept a price level higher than 9.99" (unnamed publisher, July 2009)
  - "...digital companies may disintermediate traditional publishers altogether" [...] "we appear to be on a collision course with Amazon. It will not be possible for any individual publisher to mount an effective response, because of both the resources necessary and the risk of retribution" (Penguin, August 2009)
December 2009

**DOJ evidence:**

*Our goal is to force Amazon to return to acceptable sales prices through the establishment of agency contracts in the USA...To succeed our colleagues must know that we entered the fray and follow us*

(unnamed publisher, December 2009)

By JEFFREY A. TRACHTENBERG

Simon & Schuster is delaying by four months the electronic-book editions of about 95 leading titles coming out early next year, taking a dramatic stand against the cut-rate $9.99 pricing of e-book best sellers.

A second publisher, Lagardere SCA's Hachette Book Group, said it has similar plans in the works.

"The right place for the e-book is after the hardcover but before the paperback," said Carolyn Reidy, CEO of Simon & Schuster, which is owned by CBS Corp. "We believe some people will be disappointed. But with new [electronic] readers coming and sales booming, we need to do this now, before the installed base of e-book reading devices.
Enters Apple...

- Apple met with all publishers in NYC on December 15-16
- "Hachette and HarperCollins took the lead in working with Apple to capitalise on this golden opportunity for the Publishers to achieve their goal of raising and stabilising retail ebook prices above 9.99 by collectively imposing the agency model on the industry"
- Publisher CEOs were in contact with each during this period (a total of 56 phone calls to one other during the December-January period)
- Apple negotiated with publishers into January 2010, and "kept each Publisher informed on the status of its negotiations with other publishers", "assuring them that its proposal were the same to each", and "thus serving as a critical conspiracy participant"
- Apple realised that under the proposed agency agreements prices would increase
Example of Apple-publisher exchange

To persuade one of the publishers to sign the agreement, Steve Jobs wrote to an executive of the publishers, illustrating three options:

- “Keep going with Amazon at $9.99”
- “Hold back your books from Amazon”
- “Throw in with Apple and see if we can all make a go of this to create a real mainstream e-books market at $12.99 and $14.99” (allegedly a superior path to the higher retail ebook price sought by the publishers)
Apple agency agreements

Signed by each of the 5 publishers with Apple in late January 2010, within 3 days of each other

Key terms include

- Publishers set the price (RPM), subject to a maximum price grid ($12.99 -14.99 for bestsellers)

- Agent (Apple) gets 30% commission on sales

- Most-Favoured Customer clause: publisher obliged to match lower retail price charged by any other retailer (even if publisher does not control that retailer)
Price grids (US standard)

Customer Pricing

1. United States (all prices in US dollars)

For New Release titles with list prices of $40 or less, Publisher shall determine in its discretion a Customer Price not greater than the Maximum Customer Price from among the following corresponding price bands:

<table>
<thead>
<tr>
<th>Publisher Hardcover List Price</th>
<th>Maximum Customer Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.01-9.99</td>
<td>$100% of Publisher Hardcover List Price</td>
</tr>
<tr>
<td>$10.00-21.00</td>
<td>$9.99</td>
</tr>
<tr>
<td>$21.01-$22.50</td>
<td>$10.99</td>
</tr>
<tr>
<td>$22.51-$25.00</td>
<td>$11.99</td>
</tr>
<tr>
<td>$25.01-$27.50</td>
<td>$12.99</td>
</tr>
<tr>
<td>$27.51-$30.00</td>
<td>$14.99</td>
</tr>
<tr>
<td>$30.01-$35.00</td>
<td>$16.99</td>
</tr>
<tr>
<td>$35.01-$40.00</td>
<td>$19.99</td>
</tr>
</tbody>
</table>

Maximum Customer Price means the highest price band for that range of list price, provided that Publisher can set a lower Customer Price in its discretion.

For books then-currently on the NYT Bestseller List that list for $30 or less, the Customer Price will be no greater than $12.99; and that list between $30.01-35, the Customer Price will be no greater than $14.99. “NYT Bestseller List” means the...
Example of Apple MFC clause

"If, for any given eBook New Release, the then-current Customer Price in a particular country in the Territory is materially higher than its customer price offered by any other eBook distributor to consumers in such country ("Other Customer Price"), then, Publisher shall, within two days following Publisher becoming aware of such Other Customer Price, set a new Customer Price for such country not to exceed the lowest known Other Customer Price" (from standard iBookStore contract, available on the internet).

This MFC exposed the publishers to very low effective wholesale prices if Amazon was not on the agency model

- Low retail prices by Amazon (e.g. $9.99) would need to be matched under the agency contract with Apple, implying an effective wholesale price of 70% of $9.99 for the publisher (e.g. $7), well below those received from Amazon
Impact of the MFC clause

The MFC worked as a "commitment mechanism", to force other retailers to accept agency

"Apple understood that the retail price MFC was the key commitment mechanism to keep the Defendants advancing their conspiracy in lockstep"

- "It's a giant win to keep pushing the MFN and forcing people off the Amazon model and onto ours" "Eddy's explanation [is] that it does not have to be that broad – any decent MFN forces the model" (internal Apple email, Spring 2010)
Amazon screwed it up. It paid the wholesale price for some books, but started selling them below cost at $9.99. The publishers hated that – they thought it would trash their ability to sell hardcover books at $28. So before Apple got on the scene, some booksellers were starting to withhold books from Amazon. So we told the publishers “We’ll go to the agency model, where you set the price, and we get 30%, and yes, the customer pays a little more, but that’s what you want anyway”. But we also asked for a guarantee that if anybody else is selling books cheaper than we are, then we can sell them at the lower price too. So they went to Amazon and said “You’re going to sign an agency contract or we’re not going to give you the books”.

We were not the first people in the book business. Given the situation that existed, what was best for us was to do this aikido move and end up with the agency model. And we pulled it off.
Interviewer: Why should she buy at 14.99 when she is buying for 9.99 on Amazon?
S. Jobs: Well, that won’t be the case
I: You mean that you won’t be 14.99, or they won’t be 9.99
SJ: Eh... the prices will be the same
I:...OK
SJ: Publishers are actually withholding books from Amazon, because they are not happy
Start of e-books war...

The Apple-Amazon eBook War Begins: Amazon Deletes Macmillan Books

Matt Buchanan | January 30, 2010 | 2,608 | 22

Books published by Macmillan mysteriously poofed from Amazon yesterday. The reason, according to the NYT, is that Amazon is punishing the publisher for arguing that the price of Kindle books should go up to $15. This won't end well.

It feels like a repeat of the same shit Universal Music, and later, NBC Universal pulled with iTunes, trying to counter the leverage Apple had because of iTunes' insane market share. Same situation here, really: Content provider wants more money/control over their content, fights with the
Amazon bows to Macmillan over e-books

By Tim Bradshaw in London, David Gelles in San Francisco and Kenneth Li in New York

Amazon has backed down in a dispute with Macmillan over e-book pricing and has restored the publishers’ books to its online store.

The climbdown could encourage other publishers to follow Macmillan’s lead, pushing up e-book prices.

Macmillan has been pushing Amazon to adopt a new model for selling e-books that would give publishers more flexibility in setting prices than the online retailer currently allows.

It prefers the “agency” model used for selling books by Apple for its forthcoming iPad device – whereby the retailer takes a 30 per cent commission – to the “wholesale” terms for Amazon’s Kindle, the current leader in e-readers.

Amazon responded on Friday by pulling all Macmillan’s physical and digital titles – which in the US include Hilary Mantel’s Booker-winning Wolf Hall – from its website and Kindle e-book store.

But after just two days, Amazon said it would resume selling Macmillan titles in spite of its “strong disagreement” with the publisher’s plans to charge higher prices for its e-books.
...widespread adoption of agency

E-book prices to rise as Amazon, Sony adopt agency model

By John Timmer | Published April 1, 2010 11:49 AM

With the first shipments of iPads in transit, it's looking like Apple's impending entry into the e-book market has shaken up the market's pricing structure. Apple has offered book publishers what has been termed an "agency model" for pricing, in which they get to control the price of books offered for sale via the iPad's software. Amazon had bought e-books for the Kindle at wholesale prices, and then set the prices for retail purchases. After a series of public battles with publishers, it's looking increasingly like Amazon is throwing in the towel and accepting the agency model. At the same time, and with little fuss, Sony has also adopted the agency model for pricing in its e-book store.

The Wall Street Journal is reporting that Simon & Schuster and i's NewsCorp stablemate Harper Collins have both reached new pricing agreements with Amazon. The deals will see the publishers set the prices of best sellers, many of which will increase to the $13-15 range. Similar deals with Hachette and Penguin are said to be close.

Assuming that those are completed ahead of the iPad launch, it means that Apple and Amazon will be offering very similar collections of e-book content. The remaining member of the big five publishers, Random House, hasn't announced any deal with Apple; its books will presumably remain on sale at Amazon under the existing pricing model, at least for the time being.
What happened behind the scenes?

"After it signed its Apple agency agreement, Macmillan presented Amazon with a choice: adopt the agency model or lose the ability to sell e-books versions of new hardcover titles"

"Other publisher rallied to support Macmillan"

- "[Macmillan CEO] John Sargeant needs our help" (unnamed publisher)
- "Macmillan have been brave, but they are small. We need to move the lines. Am I thrilled to know how Amazon will react against 3 or 4 of the big guys" (unnamed publisher)
- "I can ensure you that you are not going to find your company alone in battle" (unnamed publisher)
- "we believed that whatever was happening, [Amazon] was going to face, they're going to have more of the same in the future one way or another" (Macmillan)
What were the effects?

Retail prices set according to Apple price tiers

- Ostensible maximum prices, but in practice actual e-book prices
- Once agreements took effect, publishers raised prices to the maximum price level
- This was true for nearly all bestsellers also two years after the entry into the agency contracts

Agency model and higher retail prices exported to the rest of the industry

- Amazon accepted agency agreements with all five publishers shortly after Apple's entry
Legal assessment?
Legal assessment EU

The 5 publishers and Apple engaged in a concerted practice with the object of raising retail prices for e-books in the EEA above those of Amazon and/or of avoiding the arrival of such low prices in the first place

- Parallel behaviour: agency agreements with "same key pricing terms"
- Direct and indirect contacts
- Retail price MFN commitment device to force Amazon on the agency model
- Restriction of competition by object
Legal assessment DOJ

"Per se" infringement

- Publishers and Apple engaged in a "conspiracy and agreement" to "raise, fix and stabilize e-book prices, to end price competition between retailers, and to limit competition" among publishers by "collectively adopting and adhering to functionally identical methods of selling e-books and price schedules" prices
- Agency agreements implemented this "conspiracy and agreement" (coordination device)

"Rule of reason" approach

- Even if "per se" approach not accepted, the conspiracy and agreement had anti-competitive effects, by leading to higher prices (and a long list of other effects...)
Commitments: who, where, when?

First round: Final judgements/decisions

Second round: Looking for solutions
- US: Macmillan/Holtzbrinck and Penguin (Pearson)
- EU: Pearson

Third round: US court battle?
- US vs Apple
The commitments

**Publishers**
- Termination of the relevant agency agreements
- 2 year cooling-off period: retailers decide prices
- During cooling-off period: even in agency agreements discounting discretion for the retailer across the whole catalogue and up to the full aggregate commission
- 5 year prohibition on price MFN clauses

**Apple**
- Termination of agency agreements with the publishers
- 5 year prohibition on retail price MFN clauses
Court should defer to DOJ, but not when its conclusions are unreasonable.

Relief sought is an instrument of wrong to the public.

Contrary to U.S. Supreme Court and Second Circuit Precedent.

What were they thinking?

It even fails DOJ's own IP Guidelines.

It's all going digital.

IP Guidelines say copyrights are different.

E-Books are public goods—they compete with piracy.

I wrote about this in my public comments.

E-Books are Systems goods—no value to consumers in isolation.