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The Analysis of Windowing in the US eBooks Case

David Little (Latham & Watkins LLP) · Thursday, August 8th, 2013

Over the course of July and August, private practitioners and members of DG COMP alike leave Brussels for a few well-deserved weeks of holiday rest and recuperation. What reading material should the discerning competition specialist take to the beach this Summer? He/she could do worse than District Judge Cote's Opinion in *United States of America v. Apple Inc.* (the "Opinion"). The Opinion is admirably well-written and has all the elements of a Summer page-turner: corporate conspiracy, financial intrigue, tragedy (the events took place against the backdrop of Steve Jobs's final months at the helm of Apple) and – as the Plaintiffs would have it – the triumph of good over evil.

Fitting for this cinematic narrative, considerable time was devoted at trial to the issue of "windowing". Windowing involves the sale of media content – here, books – in different formats in distinct or overlapping time periods. It is common practice, in particular, in the movie industry, where studios license feature films through a series of discrete, often sequential "release windows" (*e.g.*, cinema theaters, DVD/Blu-ray, satellite, cable, and/or Internet-based pay-TV platforms, and free-to-air platforms). Windowing structures are less elaborate for book publishing because there are fewer distribution formats. However, a publisher will typically delay the release of the paperback version of a title until up to a year after hardback release. Record labels have also experimented with windowing, for example, to provide a period of exclusivity for online download services before a record is made available on streaming sites, or by sampling content on a streamed basis before official release in order to generate a "buzz" and drive pre-order sales.

During the US eBooks trial, it emerged that certain of the Defendant Publishers (Hachette, Macmillan, HarperCollins, Penguin and Simon & Schuster) sought to introduce windowing for selected titles. The eBook version of these titles would therefore be released several weeks after the hardback format. The Court found that through this practice "*the Publisher Defendants hoped to protect the sales of New Release hardcover books and to pressure Amazon to raise its e-book prices*". Apple was opposed to windowing. However, Apple encouraged the Defendant Publishers to threaten Amazon with "*deep windowing*" – delaying the release of the Kindle version of selected titles for several months – unless Amazon moved to an agency pricing model. Ultimately, moving to an agency pricing model, in which the Defendant Publishers controlled eBook prices, addressed the Defendant Publishers' concerns without having to resort to windowing.

The Opinion characterizes windowing as a counter-productive strategy that had little use beyond serving as a threat to Amazon. Representatives of the Defendant Publishers reportedly acknowledged that windowing was "*entirely stupid*" and made "*no damn sense at all really*".

Documentary and witness evidence suggested windowing could increase piracy and alienate readers, and that when a publisher delayed the release of eBooks, the lost customers neither bought the print book at a higher price nor returned to purchase the eBook.

The characterization of windowing as a commercially irrational strategy may come as a surprise to EU competition lawyers familiar with the practice of competition authorities and courts that have recognized the release windows structure as economically efficient. Economic efficiencies have been identified throughout the supply chain. For the rights holder, release windows can help to maintain content value and avoid cannibalization. For the licensee/distributor, a period of time-limited exclusivity can create incentives to invest in marketing and other activities to promote and enhance the value of the licensed content. Consumers benefit from the ability to choose among differently-priced consumption formats. Thus, in *Coditel I*, the Court of Justice found that the owner of the copyright in a film and his assigns have a legitimate interest in authorizing the TV broadcast of a film only after it has been exhibited in cinemas for a certain period of time. The Court also viewed windowing positively in *Cinetheque*. The Commission's Green Paper on the Online Distribution of Audiovisual Works acknowledges that "*any approach that removed from* [European film] *producers and distributors the opportunity to recoup investments through contractual distribution and marketing arrangements, would be likely to lead to a significant loss of incentive to invest in film production*". The Vertical Restraints Guidelines provide guidance on the "*staggered introduction of a new product*" and explains when such arrangements may fall outside Article 101. Regulatory bodies such as the UK Ofcom have recognized the possible economic efficiencies of windowing. Governments have also endorsed the practice: in France, a country with a proud history of film production, release windows are enshrined in law.

The Commission has only rarely explored potential theories of harm relating to windowing. In *COMP/M.5932 – News Corp/BSkyB* and *COMP/M. 2876 – Newscorp/Telepiu*, the theories of harm concerned not the release windows structure itself but the merged entity's control of content rights within release windows. Indeed, in *Newscorp/Telepiu*, the Commission affirmed the consumer welfare enhancing properties of the release windows structure. The Commission emphasized that consumers' "*preferences, price sensitivity and needs differ greatly, in all markets and with respect to all products*", that they should not be "*forced to consume in a 'one-format-fits-all' scenario*" and that the release windows structure offered consumers "*freedom to choose at what price and at what time to 'consume' pay-TV products*". The Commission has not found against windowing in any decision, and in the EU eBooks investigation, the theories of harm centred around allegations of co-ordination, rather than the different business models *per se*. Similarly, a coordinated effects theory was considered but ultimately discounted in *COMP/M.6789 — Bertelsmann/ Pearson/ Penguin Random House*.

Three Commission Directorates (Internal Market Services; Digital Agenda; Education, Culture, Multilingualism and Youth) have embarked upon an ambitious review of copyright and licensing rules within the EU. As with any regulatory review, there is a danger that new legal developments occurring during the lifetime of the review may be accorded undue weight and attention. For this reason, it is useful to place the analysis of windowing in the US eBooks case in context.

First, the US eBooks case does not create a tension between the US and EU view of windowing. Absent exceptional circumstances, the holder of IP rights is not under any obligation to conclude a first or subsequent sale of media content, under EU and US antitrust rules. Nor is there anything inherently anti-competitive in the rights holder using release windows to structure distribution of its content. Windowing was scrutinized in the US eBooks case not because it was unlawful in

itself but because it was the background to, and threats to "deep window" titles formed part of, a broader unlawful conspiracy to fix prices. This has little to do with traditional windowing practice, whereby right holders develop and adjust release windows unilaterally (within the parameters of applicable legislation) as a means of increasing choice for and consumption by final consumers. Although the Defendant Publishers raised in their defence something akin to a traditional justification for windowing – *i.e.*, that higher retail prices, which might be achieved through windowing, were necessary to support future content production –the evidence at trial tended to undermine rather than support this premise.

Second, the purported adverse effects of windowing described in the US eBooks case contrast with the elaborate, efficient windowing structures common in film distribution. This reminds us that the dynamics of media distribution differ between types of content (e.g., books versus music versus films/TV series) and distribution formats (physical and intangible, in their various forms). These differences may be economic: for example, in the magnitude of up-front investment required to produce content. The differences may be legal. For instance, the rights holder's distribution right exhausts upon "first sale" of physical media content, whereas intangible copies remain protected by the content owner's right of reproduction (unless a *lex specialis* applies, such as the Satellite Broadcasting Directive or Software Directive, applies) (see *Murphy*; *UsedSoft*; *Case No 4 O 191/11, LG Bielefeld*). Technical differences can also affect distribution dynamics. For instance, intangible content is easier to reproduce and resell without degradation than physical content. But it may also be possible to "turn off" the supply of intangible content (*e.g.,* by encoding downloads to "lock" after a certain period of time or by withdrawing streamed content) in a manner inconceivable for physical goods (unlike other release windows, the DVD/Blu-ray release window runs indefinitely once started). This, in turn, may affect the rights holder's ability to protect its distributors from content in other windows, affecting distributors' incentives to market content. Competition authorities conducting an effects-based analysis of media distribution arrangements must be sensitive to such differences.

Third, the brief discussion of piracy in the context of windowing in the US eBooks case reminds us that EU competition analysis has not considered the implications of piracy at any length. There have been opportunities to do so. However, the Commission has tended to side-step piracy questions or to treat arguments based on piracy considerations with skepticism when raised (usually by merging parties) (see, *e.g.*, COMP/M.6459 — Sony/ Mubadala Development/ EMI Music Publishing; COMP/M.6458 — Universal Music Group/EMI Music; COMP/M.3595 — Sony/MGM). However, piracy is a major preoccupation for media companies and deserves more than cursory consideration. Digitization and advancements in IP technology have made piracy easier and cheaper than ever before, and less easy to stop. Finding a solution to these difficulties is critical to safeguarding the long-term future of creative industries. Rights holders are exploring legislative and commercial means of reducing piracy levels, from entirely new business models to variations on established distribution schemes. Outside the boundaries of clearly unlawful conduct, competition authorities should give rights holders the benefit of the doubt and freedom to do so.

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