

# Legal Update from Brian Flagler

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## A New eBook Revenue Model for Publishers?

Many predict that Apple's announcement of the iPad last week may dramatically change the eBook industry. But an event that played out between Amazon and Macmillan over the weekend may have more immediate effects.

Large trade publishers have recently been struggling with the question of when to launch eBook editions of their new releases. With Amazon pricing eBooks at \$9.99, publishers have been reticent to simultaneously release Kindle editions of their top selling hardcover books, which often retail in the \$25 range, for fear that the cheap Kindle edition will cannibalize sales of the hardcover. Over the long term, publishers, authors and some agents have expressed concern that the price discrepancy will devalue the entire concept of the book. And the ABA and CBA have claimed in separate letters [[ECPA Legal Update, Oct. 2009](#)] to the Department of Justice that Amazon's pricing strategies violate the antitrust laws.

Enter Apple. In contrast to Amazon's Kindle "distribution" model of paying the publisher a percentage of the retail price regardless of the discounted price Amazon charges its customer, Apple reached deals with many of the largest New York houses on an "agency model." John Sargent of Macmillan describes the model:

*"Under the agency model, we will sell the digital editions of our books to consumers through our retailers. Our retailers will act as our agents and will take a 30% commission (the standard split today for many digital media businesses). The price will be set for each book individually."*

The significant issue here is one of control. Under the agency model, the sale transaction occurs between the publisher and the end consumer. The eBook retailer, such as Apple's iBook store or Amazon, will serve as the publisher's sales agent in the transaction. But because it is the publisher's sale, the publisher decides the price.

The day after Apple unveiled the iPad and its "agency model" deals with a number of large trade publishers, John Sargent of Macmillan flew to Seattle to inform Amazon that it would only offer new release eBooks to Amazon under the agency model. Amazon would no

longer be able to set the price of Kindle editions of Macmillan's new releases. Rather, Macmillan would set the price, and it would be up to \$14.99 for their best sellers.

Amazon responded the next day with what some have termed the "nuclear option": turning off the "buy" buttons for Macmillan's eBooks on the Amazon site. This generated quite a furor in the blogosphere over the weekend. Monday morning, Amazon capitulated to Macmillan's terms.

These recent events may trigger more questions than answers, but the tiff between Amazon and Macmillan highlights that publishers still have some leverage and numerous options when it comes to the distribution of their eBooks. ECPA publishers should be aware that competition in the marketplace is pushing the revenue share for eBooks further into the hands of publishers. If you negotiated your eBook deals even a year ago, you should evaluate whether you are receiving market terms from Amazon, Barnes & Noble, and others.

Additionally, some have wondered how the past week's events will affect the ABA/CBA antitrust claims and how the agency model allows publishers to set the price to consumers without running afoul of those laws. Initial thoughts on these questions are below.

#### **Effect on ABA/CBA claims to DOJ**

I don't think these developments will have a significant impact on the objections by the ABA and CBA to Amazon, Wal-Mart, and Target's "loss-leader" pricing of bestsellers. This agency model only applies to digital editions, and the ABA and CBA's objections are primarily tied to the prices these online retailers are offering for hardcovers. I previously shared [[ECPA Legal Update, Oct. 2009](#)] why I don't think the retail associations have a viable antitrust claim in the absence of evidence that Wal-mart and Amazon are colluding or evidence that they intend to raise prices after they drive out competition. It appears that they are simply competing with each other.

#### **Is it illegal for publishers to set the price to the consumer under the agency model?**

Based on the available information about the model, and some assumptions about terms included in these agency agreements (which I have not seen), a publisher can structure an agency agreement in a fashion that allows the publisher to specify the sales price without violating the Sherman Act. Macmillan cannot tell Amazon the price at which Amazon sells hardcovers because Amazon is holding the inventory and making the sale (in other terms, Macmillan cannot "fix the price" at which Amazon sells copies of books sitting in Amazon's warehouse). But if Macmillan wants to hire sales reps to sell its books directly to consumers, Macmillan can decide the price at which the rep offers the book for purchase. Essentially, Macmillan is telling Amazon that it is not going to sell new release eBooks to Amazon when the hardcover releases. Instead, they are going to hire Amazon as their sales agent to facilitate sales of these new release eBooks by

Macmillan directly to consumers. Because the sale will be by Macmillan to the consumer, Macmillan can specify the price. [Some reports indicate](#) the other large New York houses are likely to follow suit.

This issue highlights a significant difference between eBook sales and print book sales. Macmillan can pretty easily change its eBook distribution model from one of sale to retailers to one of hiring retailers to serve as sales reps. Why? Because eBook distribution does not involve the significant challenges involved in warehousing inventory and fulfilling orders for printed books. Amazon and Wal-Mart are famously efficient at moving physical products to consumers, but digital distribution provides a much more level playing field for publishers. Which is what freed Macmillan to take the stand they did over the weekend.



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