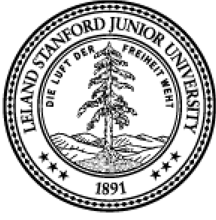

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Transatlantic Antitrust and IPR Developments

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Contents

ANTITRUST **5**

United States **5**

US DOJ announces first criminal prosecution into online price fixing 5

European Union **6**

European Commission sends formal charges to Google on comparison shopping services and opens separate investigation on Android 6

Commissioner Vestager announces proposal for e-commerce sector inquiry 12

Online hotel booking investigations in Europe at a cross-road: waiting for Godot? 14

Italian competition authority investigates Italian Stock Exchange practices 18

Swiss Competition Commission approves merger of local.ch and search.ch 20

INTELLECTUAL PROPERTY **21**

United States **21**

3C is fair use, too 21

Supreme Court holds that TTAB's decisions have preclusive effect on courts 24

European Union **28**

Case C-463/12 Copydan Båndkopi v. Nokia Danmark A/S 28

EU Court rules on hyperlinks to live broadcasts on the Internet 31

European Court of Justice: reduced VAT rate cannot be applied to supply of e-books 33

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Gabriele Accardo is a lawyer and scholar who, after nearly twelve years of professional and academic experience, has developed a strong expertise in competition law and other complex areas of law that deal with business and innovation. In the early stages of his career he spent ten years in Brussels (until 2011), where he practiced EU and competition law at two leading international firms, Lovells and WilmerHale. Currently, he practices law in Rome, Italy. In 2009, his passion for research on international technology laws brought him to start collaborating as a Research Fellow at the TTLF. He recently co-founded Innoventually, a start-up that acts as the one-stop-shop for assisting public and private entities and individuals in the creation, management, protection, promotion, development and monetization of innovative solutions. Gabriele is a non-governmental advisor to the Italian Competition Authority in the ICN (Merger working group), and Director for Italy of the European Mediterranean Competition Forum.

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Antitrust

United States

US DOJ announces first criminal prosecution into online price fixing

By Gabriele Accardo

On April 6, 2015, the US Department of Justice's Antitrust Division announced the first criminal prosecution of a conspiracy specifically targeting e-commerce. The case arose from an ongoing federal antitrust investigation into price fixing in the online wall décor industry.

Mr. David Topkins, a former executive of an e-commerce seller of posters, prints and framed art, has agreed to plead guilty to conspiring to fix the prices of posters sold online, and to pay a fine of $20,000. His plea agreement requires court approval. Price fixing in violation of Section 1 of the Sherman Act carries a maximum sentence of 10 years and a fine of $1 million for individuals, which makes the case even more exceptional in that, despite the very serious offence (price fixing), Mr. Topkins would dodge prison time.

According to the charges, Mr. Topkins and his co-conspirators participated in conversations and communications with representatives of other poster-selling firm to discuss (that is fix, increase, maintain and stabilize) the prices of the agreed-upon posters sold online through Amazon Marketplace, from as early as September 2013 until in or about January 2014. Amazon was not charged in the case.

To implement the anticompetitive agreement, Mr. Topkins and his co-conspirators adopted specific pricing algorithms with the goal of coordinating changes to their respective prices and wrote computer code that instructed algorithm-based software to set prices in line with the agreement. Similar algorithm-based pricing software is common in online marketplaces, but its use is not indicative of any wrongdoing absent this sort of coordination.

Although there is little information available, the case appears to show that the companies concerned used the "traditional tool-box" of anticompetitive behavior, such as contacts and exchange of information, etc.

According to the Department of Justice, this case arose from an ongoing federal antitrust investigation into price fixing in the online wall décor industry, so we should expect more of the same in the coming months. Watch this space.

Antitrust

European Union

European Commission sends formal charges to Google on comparison shopping services and opens separate investigation on Android

By Gabriele Accardo

On 15 April 2015, the European Commission sent a statement of objections to Google, alleging that the company is abusing its dominant position in the Internet search market, in breach of Article 102 of the Treaty on the Functioning of the European Union ("TFEU"), by systematically favouring its own comparison shopping product "Google Shopping" in its general search results pages.

In parallel, the Commission launched a separate formal investigation concerning the mobile operating system Android. The investigation will focus on whether Google has entered into anti-competitive agreements or abused a possible dominant position, in breach of Article 101 TFEU and/or 102 TFEU, in the field of operating systems, applications and services for smart mobile devices.

I. The alleged abuse in the Internet search market

This investigation does not come as a surprise.

In fact, during the past four years, Google has been in talks with the European Commission to address four set of competition issues, including the way Google displays specialized search services vis-à-vis its own products (see Newsletter 1/2014, Newsletter 5-6/2013, Newsletter No. 2/2013, Newsletter 2/2010, for additional background). While the present investigation focuses on Google's favouring its comparison shopping product, the Commission continues to investigate Google's conduct with regards to the allegedly more favourable treatment of other specialized search services, as well as Google's conduct in three other areas of concern: copying of rivals' web content (AKA "scraping"), advertising exclusivity and undue restrictions on advertisers.

In February 2014, Google was very close to a settlement, having offered a comprehensive package of remedies to the Commission.

However, while complainants made their voices louder, the mandate of the previous Commission was about to expire, so it soon became clear that the new Commissioner in charge for Competition would take over the case.

In recent months, dark clouds over Brussels began to gather.

Last 27 November 2014 the European Parliament passed a non-binding resolution, which called on the Commission to "*properly enforce the EU competition rules in order to prevent excessive market concentration and abuse of dominant position and to monitor competition with regard to bundled content and services.*" While the appetite of politicians to get involved in the Commission's own turf may be understandable, that resolution left many perplexed nonetheless.

Yet, even more striking were certain passages of the public speech that EU Commissioner for Digital Economy and Society gave just a day before the Commission sent charges to Google. Commissioner Oettinger hinted at some forms of regulatory actions allegedly needed to fill, amongst others, the gap between EU and US Internet platforms.

That speech was not mere propaganda. In fact, a leaked Commission's draft document "A Digital Single Market Strategy for Europe" stated that "*The market power of some online platforms in the digital economy raises a number of issues that warrant further analysis. The Commission will carry out a comprehensive investigation and consultation on the role of platforms, including the growth of the Sharing Economy. The Commission's analysis will cover i.a. issues like those arising from the lack of transparency in the search results (involving paid for links and/or advertisement) and the way Platforms use the information they acquire, possible issues relating to fair remuneration of rights-holders and limits on the ability of individuals and business to move from one platform to another [update after Google decision]*". Even a distracted reader may wonder whether that "*update after Google decision*", should simply read that either way Google shall adapt its business model to much more stringent requirements. The final version of the Digital Single Market Strategy for Europe and its accompanying Commission Staff Working Document have been released after this issue of the Newsletter had been completed, so these will be addressed in the next issue.

And let's not forget another leaked document of last March, albeit the leak came from the other side of the Atlantic. As it may be recalled, the Wall Street Journal published the staff report (actually, the document only included every other page of the report) from the US FTC's bureau of competition recommending the FTC to bring a lawsuit against Google. The leak raised lots of eyebrows because, in early 2013, contrary to the staff recommendation, the FTC's commissioners voted unanimously (5-0) to end the investigation into allegations of search bias after Google agreed to some voluntary changes to its practices. In that respect, the statement by the FTC reads "*The totality of the evidence indicates that, in the main, Google adopted the design changes that the Commission investigated to improve the quality of its search results, and that any negative impact on actual or potential competitors was incidental to that purpose. While some of Google's rivals may have lost sales due to an improvement in Google's product, these types of adverse effects on particular competitors from vigorous rivalry are a common byproduct of "competition on the*

merits" and the competitive process that the law encourages." Specifically, the Commissioners held that "*Product design is an important dimension of competition and condemning legitimate product improvements risks harming consumers. Reasonable minds may differ as to the best way to design a search results page and the best way to allocate space among organic links, paid advertisements, and other features. And reasonable search algorithms may differ as to how best to rank any given website. Challenging Google's product design decisions in this case would require the Commission – or a court – to second-guess a firm's product design decisions where plausible procompetitive justifications have been offered, and where those justifications are supported by ample evidence.*"

Interestingly, in its press release, the Commission acknowledged the close cooperation in this matter with the European Commission's Directorate-General for Competition. In the wake of the recent developments, it is not clear whether that sense of cooperation still exists, or whether the European Commission has had an after-thought about cooperating with the FTC.

Against this background, Commissioner Vestager assured that competition investigations are independent from politics and commercial interests, noting that one out of four individual companies that complained in this case is a US company, and that US companies also play a major role in complaining business associations.

While there is no doubt that Commissioner Vestager is independent from political pressure, too many actors appear very interested to jump onto the stage. The risk of confusion is real, let alone the risk that good and much needed measures to achieve the Digital Single Market in Europe get mixed with or, worse, traded for far-reaching regulatory measures in a sector that has thrived, and can only thrive, thanks to innovation, not regulation.

The preliminary conclusions in the SO

The grievances concerning Google's alleged abuse in the Internet search market are well known.

In essence, the statement of objections alleges that Google treats its own "Google Shopping" service more favourably in its general search results, compared to rival comparison shopping services. This artificially diverts traffic from these rival services stifling innovation and hindering their ability to compete to the detriment of consumers,

More specifically, the Commission's preliminary conclusions are:

- Since 2008, Google has systematically positioned and prominently displayed its comparison shopping service in its general search results pages, irrespective of its merits.

- Google does not apply to its own comparison shopping service the system of penalties applied to competing services, which can lead to the lowering of the rank in which they appear in Google's general search

results pages.

- Froogle, Google's first comparison shopping service, did not benefit from any favourable treatment, and performed poorly, whereas its subsequent comparison shopping services "Google Product Search" and "Google Shopping" experienced higher rates of growth as a result of the alleged abusive conduct, to the detriment of rival comparison shopping services.

- Users do not necessarily see the most relevant comparison shopping results in response to their queries. Incentives to innovate from rivals are lowered as they know that however good their product, they will not benefit from the same prominence as Google's product.

In brief, as those who still go shopping at supermarkets may understand, this is no different than what supermarket chains do with their private labels. While supermarkets also know a lot about our tastes (guess what customer loyalty cards are made for), the main difference is that shelf space in supermarket alleys is rather scarce, whereas virtual space on Google search pages is not. One may wonder though whether another important difference is that Internet users are considered somewhat lazier when they browse the Internet than when the same individuals go shopping and browse the shelves in search of their favorite cola.

A remedy Google can't refuse (to offer)?

Allegedly without the aim of seeking to interfere with either the algorithms Google applies or how it designs its search results pages, the Commission takes the preliminary view that in order to remedy the allegedly abusive conduct, Google should treat its own comparison shopping service and those of rivals in the same way. Accordingly, the Commission expects that when Google shows comparison shopping services in response to a user's query, the most relevant service or services would be selected to appear in Google's search results pages.

It is hard to imagine that the Commission's wishes would not interfere with the algorithms applied by Google or the product design, an approach that clearly clashes with that of the Federal Trade Commission, briefly illustrated above.

Under Article 9 of Regulation 1/2003 Google may still offer commitments, albeit of a different nature than those offered last year (see Newsletter 1/2014).

But if Google is not willing to offer something more substantial than it did in 2014, under Article 7 of Regulation 1/2003, with the decision finding an infringement of the EU competition rules, the Commission may *impose* any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end. In such cases, the Commission can also impose a fine of up to 10% of the worldwide turnover of the undertaking concerned.

The difference between a prohibition decision under Article 7 and a commitment

decision pursuant to Article 9 of Regulation 1/2003 is that the former contains a finding of an infringement (and may come with a fine) while the latter makes the commitments binding without concluding on whether there was or still is an infringement.

II. The investigation concerning the mobile operating system Android

The second investigation concerns Google's mobile operating system Android, the leading operating system for smart mobile devices in the European Economic Area.

Other mobile operating systems include Apple's iOS (which is proprietary to Apple and runs only on iPhones and iPads) and Windows Phone (which is used on Microsoft's and other manufacturers' smartphones and tablets).

Android is an open-source mobile operating system that can be freely used and developed by anyone. The majority of smartphone and tablet manufacturers, however, use the Android operating system in combination with a range of Google's proprietary applications and services. In order to obtain the right to install these applications and services on their Android manufacturers need to enter into certain agreements with Google.

The investigation will focus on the following three allegations:

- Whether Google has illegally hindered the development and market access of rival mobile applications or services by requiring or incentivizing smartphone and tablet manufacturers to exclusively pre-install Google's own applications or services, in particular Google's search engine;
- Whether Google is hindering the ability of manufacturers of smartphones or tablets, who want to use the Android operating system, from being able to use and develop other open-source versions of Android (so-called "Android forks");
- Whether Google has illegally hindered the development and market access of rival applications and services by tying or bundling certain Google products with other apps and services.

In brief, the Commission will assess if, by entering into anticompetitive agreements and/or by abusing a possible dominant position, Google has illegally hindered the development and market access of rival mobile operating systems, mobile communication applications and services in breach of either Article 101 TFEU and/or Article 102 TFEU.

While there are some similarities with the Microsoft case concerning the PC operating system market, it is still too early to say whether the conclusion will be the same.

Some interim thoughts

The last four years have seen Google under the spotlight in different European venues, often portrayed as a villain or the 800-pound gorilla in the room.

What is striking, however, is that the

debate in Europe has not done much to change the way we (Europeans) see and reward innovation, and more generally "merit". Arguably, this is at the root of a bunch of problems that some in Brussels or in other European capitals believe can be solved with more regulation.

In a recent interview, US President Obama, answering a question concerning the investigations that Google and other US Internet companies face in Europe, somewhat provocatively said "*We have owned the Internet. Our companies have created it, expanded it, perfected it in ways that they* [European companies] *can't compete. And oftentimes what is portrayed as high-minded positions on issues sometimes is just designed to carve out some of their commercial interests.*"

President Obama's statement, however exaggerated, should be taken as an encouragement to do more to support innovation: it is true that US companies are at the forefront of innovation, especially in the Internet space, but it is not true that European companies are mere followers that cannot compete but for the intervention of regulatory measures.

Antitrust
European Union

Commissioner Vestager announces proposal for e-commerce sector inquiry

By Gabriele Accardo

On March 26, 2015, Competition Commissioner Margrethe Vestager announced the imminent launch of a competition inquiry in the e-commerce sector. After this issue of the Newsletter had been completed, the Commission announced (see also the Memo) the launch of the E-commerce Sector Inquiry, which will be addressed in the next issue.

The sector inquiry will focus on private—and in particular contractual—barriers to cross-border e-commerce in digital content and goods, since significant cross-border barriers to e-commerce still exist within the EU.

Knowledge gained through the sector inquiry will not only contribute to enforcing competition law in the e-commerce sector but also to various legislative initiatives which the Commission plans to launch to boost the Digital Single Market.

The Commission updated the Block Exemption Regulation and the Guidelines on Vertical Restraints in 2010 (see Newsletter 3/2010, for additional background). The review made clear that, in principle, every distributor must be allowed to use the Internet to sell its products, whereas consumers must be allowed to look for the best deals online wherever they want.

While Commissioner Vestager noted that these rules are there to give legal certainty to companies and make sure that the law is applied in the same way throughout Europe, she also acknowledged that online business and markets move quickly and the Vertical Guidelines can only provide a general framework.

While there are a number of ongoing investigations (licensing contracts between US film studios and European broadcasters; online restrictions in the consumer-electronic market; and geo-blocking measures concerning certain video games sold online), the varied nature and scope of these investigations means that any insights will be incomplete and sector-specific.

In order to obtain thorough market knowledge, the Commission will seek information from, among others, holders of content rights, broadcasters, manufacturers, merchants of goods sold online, and the companies that run online platforms such as price-comparison and marketplace websites. Commissioner Vestager has stated that a possible target date for preliminary findings is mid-2016.

In the past, the Commission has conducted competition inquiries in various sectors,

including energy, financial services and pharmaceuticals. As a result of such inquiries, the Commission has carried out a number of individual investigations.

Antitrust

European Union

Online hotel booking investigations in Europe at a cross-road: waiting for Godot?

By Gabriele Accardo

On April 21, 2015 the French, Swedish and Italian competition authorities jointly announced they have accepted—and made legally binding—the commitments (see FRA, ITA, SWE) offered by Booking.com, thus closing their respective investigations into the online hotel booking platform. The three authorities had also opened proceedings against Expedia. These proceedings are still pending.

The investigations concerned the clauses in the contracts between Booking.com and hotels that obliged hotels to offer Booking.com the same or better room prices and conditions as the hotels made available on all online and offline distribution channels (so-called "Most Favored Nation" or "MFN" clauses), including, for instance other Online Travel Agencies ("OTAs") as well as hotels' direct sales channels (see, Newsletter 1/2015, p. 17 Newsletter 3/2014, p.12 Newsletter 1/2014, p.15, Newsletter 5-6/2013, p.9 and 11, Newsletter No. 4-5/2012, p. 15, for additional background).

Such MFN clauses were deemed in breach of both national and EU competition rules, by restricting competition between Booking.com and other OTAs and hindering new booking platforms from entering the market.

The commitments offered by Booking.com consist of reductions in the scope of the MFN clauses.

Price parity vis-à-vis other OTAs. First, Booking.com committed to abandon the parity requirement in respect of prices which hotel make available to other OTAs. This would enable hotels to offer different room prices and/or better commercial conditions to different OTAs, and allocate them larger quotas of rooms.

Price parity vis-à-vis hotels direct sales. Secondly, hotels may also offer prices at a lower rate than those displayed on the Booking.com website via their offline sales channels (on-site bookings, by telephone, fax, email, instant messaging, physical sales outlets of travel agencies, etc.) as long as these prices are not published on the hotel's website. They may also offer prices at a lower rate than those displayed on the Booking.com website to customers who are members of loyalty programs.

However, hotels would still have to offer the same or better room prices to Booking.com as are offered to the general public on the hotel's own online booking channels. Nonetheless, hotels' websites accessible by the general public may display qualitative information regarding

the prices offered via their offline channels, such as "attractive prices", "good prices", etc. Furthermore, hotels will be allowed to send emails and SMS messages to consumers informing them of the prices offered via their offline channels, as well as to reach out to previous customers and offer them special discounts.

Other conditions. In addition, hotels may reserve a greater number of rooms to their direct online or offline sales channels than are allocated to Booking.com. Hotels will also be completely free to offer consumers more favourable conditions than those offered on Booking.com via other platforms and via their own offline channels. This includes breakfast or any other service (e.g. gym, spa, Internet access, etc.) as well as booking conditions (e.g. cancellation).

In essence, the commitments accepted by the competition authorities increase the hotels' margin for maneuver, while acknowledging that price parity may be important in preventing free-riding on Booking.com's investments and thus ensuring the continued offering of user-friendly search and comparison services free of charge.

In this respect, the three NCAs appear to have acknowledged that MFN clauses may bring about some efficiency. That is somewhat surprising given that during the market tests, stakeholders pointed to the fact that OTAs—not hotels—are the free-riders, notably on the investments made by hotels (e.g., brand, hotel facilities, quality of services provided to customers etc.), e.g. by purchasing hotels brands as keywords for online search. Also, hotels and other stakeholders actually expressed concerns that even a "narrow MFN" clause would produce the same effects as the fully-fletched MFN clause, since hotels would have basically no incentives to grant other OTAs lower prices than the price displayed on their own online sales channel (due to the risk of cannibalizing their direct sales).

It is not clear whether, in the light of their concerns, the intervening parties will decide the appeal the commitment decision(s).

Investigations in Germany…

While the French, Italian and Swedish competition authorities cheered the outcome of their cooperation and the coordination of the European Commission, the Federal Cartel Authority ("FCA") in Germany was actually heading in the opposite direction on the very same issues in an ongoing investigation against Booking.com.

In fact, on April 2, 2015, the FCA sent formal charges to Booking.com regarding the use of "best price" clauses in its contracts with hotels in Germany.

In so doing, the FCA followed the same path it had already walked against HRS, another online booking portal once dominant in Germany.

In fact, according to the FCA, the statement of objections against Booking.com was necessary because the hotel booking portal had continued to use its best price clauses despite the fact that the FCA had prohibited similar clauses with

a decision in the parallel proceedings against HRS.

The FCA's decision was recently upheld by the Düsseldorf Higher Regional Court, which confirmed that HRS's "best price" clauses restricted competition to such a degree that they could not be exempted under the EU Block Exemption Regulation (HRS's market share was higher than 30%) or with an individual exemption (arguably, because the FCA found that such clauses brought about no efficiencies).

…and in the UK

These recent developments are particularly relevant in the context of the new investigation that the UK Competition and Markets Authority ("CMA") has to carry out into Booking.com's MFN clauses (the CMA replaced the Office of Fair Trading or "OFT" on April 1, 2014).

On September 26, 2014 the UK's Competition Appeal Tribunal ("CAT") reversed the OFT's January 20th decision to accept commitments from online travel agents Booking.com B.V. ("Booking.com", and its ultimate parent company Priceline.com Incorporated) and Expedia Inc. ("Expedia"), together with InterConti-nental Hotels Group plc. ("IHG") (see Newsletter 4-5/2014, Newsletter 1/2014, Newsletter 5-6/2013 and Newsletter No. 4-5/2012 for additional background).

In the wake of the CAT's decision, the case has been sent back to the CMA, which has been ordered to reopen the investigation into hotel online booking practices.

In its ruling the CAT noted that "*by pursuing its investigation on the basis that it had identified restrictions 'by object' the OFT may have deprived itself of the ability properly to appreciate the significance of the role of operators such as Skyscanner, even though it had initially acknowledged the importance of price transparency as a force for competition and was aware, at least, that meta-search operators existed.*"

It is worth recalling that in November 2013, the FCA and the OFT closed their respective investigations into Amazon's price parity policy on its Marketplace platform following Amazon's decision in August 2013 to end its Marketplace price parity policy across the European Union (see Newsletter 5-6/2013, p. 12, for additional background). The policy prohibited third party retailers from offering products through other online sales platforms cheaper than on Marketplace.

While it is hard to predict the outcome of the new investigation by the CMA, third parties and complainants may point to the recent developments illustrated above to call for a stricter approach by the CMA. In turn, the businesses under investigation may arguably prefer to settle the case once and for all by offering improved commitments in line with the French, Italian and Swedish cases. If that occurs, the German approach will be "singled out" as the stricter one in the European competition arena.

The issues assessed by several national competition authorities in Europe in the online booking sector were the perfect candidate for an EC investigation, which

would have provided greater legal certainty at a faster speed. The reasons why this did not happen are unclear to most, and certainly the coordination efforts recently undertaken are no substitute for clear-cut enforcement. Historians of EU competition law may find the issue interesting to investigate.

Antitrust

European Union

Italian competition authority investigates Italian Stock Exchange practices

By Gabriele Accardo

On 14 April 2015, the Italian Competition Authority ("ICA") launched an investigation (only available in Italian) against London Stock Exchange Holdings Italia ("LSEHI") and its subsidiaries Borsa Italiana ("BI", which manages stock trading platforms and infrastructure) and BIt Market Services ("BIMS", which provides financial news services to traders in the downstream market) for an alleged abuse of dominant position in the financial information services market, in breach of Article 102 of the Treaty on the Functioning of the European Union.

BI manages stock trading platforms and infrastructure, and sells financial data regarding the transactions executed through its trading platforms to financial intermediaries or information providers, such as BIMS and eClass. In turn, BI and eClass are "vendors" of such data, which they use to carry on their own activities in the downstream markets for the provision of financial information.

The investigation was launched following the complaint by eClass in respect to:

- BI's contractual terms which required each *vendor* to provide BI with a detailed list of their customers and the type of data purchased by each customer, on a monthly basis; and
- BI's charging BIMS less than its competitors for the supply of market data, thereby allowing its sister company to submit better offers to the clients of its competitors.

According to the ICA, LSEHI and its subsidiaries may have engaged in an exclusionary strategy whereby BIMS used the information obtained by BI to win clients from the competition by designing packages that competitors could not match, especially in terms of price. This exclusionary conduct may have been facilitated by the frequent audits that BI carried out at the premises of the vendors' customers, allegedly in order to determine the quantity and type of data accessed, and ultimately the fees to be paid.

Interestingly, the ICA considers the financial information supplied by BI an essential input for information providers, so that BI's conduct may be subject to the essential facilities doctrine. In short, dominant companies should grant access to such "facility" on fair and non-discriminatory conditions in order not to hamper the development of the downstream market for the provision of financial information. The ICA argues that this is a specific requirement of the MiFID directive, which requires the manager of trading platforms to grant access to the

data generated by the platforms on reasonable commercial terms.

The issue of the provision of critical data used in financial markets has been recently addressed by the European Commission, albeit in quite different cases, against Thomson Reuters and Standard & Poor's (see, Newsletter 6/2012 Newsletter 4-5/2012, Newsletter 1/2012, Newsletter 3/2011, and Newsletter 6/2009 for additional background). In both instances, the two companies decided to offer commitments (see Standard & Poor's and Thomson Reuters) to the Commission in order to close the investigations.

Antitrust

European Union

Swiss Competition Commission approves merger of local.ch and search.ch

By Gabriele Accardo

On March 24, 2015, the Swiss Competition Commission ("COMCO") approved (press release available in French or in Italian) the merger between Swisscom Directories Ltd ("local.ch") and search.ch despite the fact that the concentration will result in the creation of a dominant position in the online directories market. Swisscom Directories, with its online directories platform local.ch and its Local Guide phone directories business, is a leading advertiser and provider of directories in Switzerland. search.ch is a leading search and information service in Switzerland. Amongst other things, it offers an electronic telephone directory, an interactive map, a route planner, local weather reports, and up-to-date TV and cinema listings.

Following an in-depth investigation, COMCO concluded that effective competition would not be impeded because the two companies will continue to operate as separate services to create strong Swiss alternatives to global providers of search engines, such as Google and social networks, such as Facebook.

Intellectual property

United States

3C is fair use, too

By Marie-Andrée Weiss

David Adjmi (Plaintiff) is the author of *3C*, a work for the stage based on the successful television show *Three's Company,* a television show which ran to great success from 1977 to 1984. Defendant DLT Entertainment Ltd. owns *Three's Company*'s copyright.

3C played Off Broadway in June 2012, which led to DLT sending Plaintiff a letter, asking him to cease further performances. Plaintiff had offers to license his play and to have *3C* included in a book, but could not do so because of litigation risk, and thus filed a complaint on January 2014 seeking a declaratory judgment that *3C* did not infringe Defendant's copyright in *Three's Company*. He argued that his use of *Three's Company* is a parody and a criticism of the television show and as such is protected by fair use.

On March 31, 2015, Judge Loretta Preska of the Southern District of New York (SDNY) issued an opinion granting Plaintiff's motion. The case is *David Adjmi v. Dlt Entertainment Ltd.*, 14 cv.0568.

Three's Company

Three's Company is a comedy, featuring three roommates, two women and a man, sharing an apartment in California. One roommate is Chrissy, a blonde secretary who is the daughter of a minister. Another roommate is Janet, a brunette working as a florist. The male roommate, Jack, is a chef-in-training who pretends to be gay so that the landlord lets him share the apartment with two women, a situation which allows for much misinterpretation and innuendo. Although the general tone of the show is comedy, it nevertheless touches upon some serious issues, such as the place of women in the workplace, sexual harassment and homophobia. Also, as noted in Plaintiff's complaint, the show reinforced some stereotypes, such as homosexual men being effeminate or older women being the object of ridicule for wanting to have a sex life.

3C

3C is set in the Seventies and features a man, Brad, a Vietnam war veteran training to be a chef, who shares an apartment with two women, Linda, a brunette florist, and Connie, a blonde daughter of a minister. However, Brad, who is presented as homosexual to the landlord so that he can share the apartment with the two women, really *is* a closeted homosexual, secretly in love with his friend Terry. The two women have serious issues such as lack of money and self-loathing, and have experienced sexual assaults, even rape. The landlord's wife is affected with serious anxiety and the landlord is a homophobic man, abusive to women, who even sexually assaults Linda during the play. The show ends with Brad telling Terry that he is homosexual and that he loves him. He starts crying and

the stage goes dark.

3C is a parody of *Three's Company*

Plaintiff described his work in his complaint as an "*original work for the stage that tells its own story with its own characters but employs elements of the iconic series Three's Company for the purposes of parody and criticism.*" While Judge Preska found *3C* to have copied original elements of *Three's Company*, she did not find this to be an infringing use as it was protected by fair use.

Fair use is an affirmative defense to a copyright infringement claim. It is codified in Section 107 of the Copyright Act, which provides four factors courts may use to determine if a particular use is fair: (1) the purpose and character of the use, (2) the nature of the copyrighted work, (3) the amount and substantiality of the portion used and (4) the effect of the use on the market. Judge Preska examined these four factors in turn.

Purpose and character of the use

While the commercial nature of *3C* weighed against a finding of fair use, the court nevertheless found the first factor to weigh "*heavily*" in Plaintiff's favor, as *3C* did not merely supersede *Three's Company*, but is instead a transformative work, which the Supreme Court found in its seminal fair use case, *Campbell v. Acuff-Rose*, to be "*at the heart of the fair use doctrine's guarantee of breathing space within the confines of copyright*" (*Campbell*, at 579). *Campbell* was a parody case, and the Supreme Court found parody to be a form of criticism, which is one of the categories recognized by Section 107 as being protected by fair use. The Supreme Court described parody as "*the use of some elements of a prior author's composition to create a new one that, at least in part, comments on that author's works*" (*Campbell*, at 580), and noted that "*a parody's commercial character is only one element to be weighed in a fair use enquiry*" (*Campbell*, at 572).

While Judge Preska found *3C* to copy the plot, characters, sets, and even some scenes of *Three's Company*, it also found it to have created "*new information, new aesthetics, new insights and understanding,*" quoting the Second Circuit 1998 *Castle Rock Entm't v. Carol Publ'g Grp., Inc.* case. For the SDNY, *3C* is "*an upside-down, dark version*" of *Three's Company*, further noting that the play deconstructs the television show and turns it "*into a nightmarish version of itself,*" using the familiarity of the show "*as a vehicle to criticize and comment on the original's light hearted, sometimes superficial, treatment of certain topics and phenomena"* (SDNY Order p. 43). Judge Preska gave as an example the difference between Jack, a character who "*serv*[*es*] *as a general source of comedy*" and Brad, who grapples "*almost the entirety of 3C… with his secret,*" a treatment which "*criticizes the happy-go-lucky treatment*" of homosexuality by *Three's Company* (SDNY Order p. 44). Judge Preska found *3C* to be "*a highly transformative parody of Three's Company"* and this determination "*weigh*[*ed*] *heavily in favor of finding fair use*" (SDNY Order p. 46).

Nature of the copyrighted work

The SDNY quoted again *Campbell*, where the Supreme Court noted that the second fair use factor is not likely to be of help in parody cases, "*since parodies almost invariably copy publicly known, expressive works*" (*Campbell* at 586). Therefore, even though this factor weighed in favor of Defendant, because the television show was "*a creative, even groundbreaking, work,*" this factor had less importance relative to the other three factors (SDNY Order p. 47).

Amount and substantiality of the portion used

"*3C copies extensively from Three's Company,"* but parody must necessarily take enough of the original work as its "*humor is entirely contingent on recognizable allusion to the original work*" (SDNY Order p. 49). Also, the Second Circuit "*has consistently held that a parody under the fair use doctrine is entitled to more extensive use of the original work than is ordinarily allowed under the substantial similarity test*"(SDNY Order p. 49). Defendant argued that *3C* had not only copied important elements of *Three's Company*, but also minor elements which were not necessary to create a parody or to evoke the original work, such as the fact that one character is the daughter of a minister, another one is working in a florist's shop, or the male roommate is training to be a chef. For Judge Preska, the use of these "*metaphorical appendages*" weighed against a finding of fair use. However, as "*the Supreme Court set a floor, not a ceiling… [which] is considered in light of the first and the fourth factor*" in *Campbell* (SDNY Order p. 51), and because the Supreme Court noted that "*the parody must be able to 'conjure up' at least enough of the original to make the object of its critical wit recognizable*" (*Campbell* at 558*),* Judge Preska found the third factor to be "of *comparatively lesser importance*."

The effect on the potential market

Defendant had argued that *3C* had diminished the market for potential stage adaptation of *Three's Company*, and that it fulfilled the same market demand as the original work. These arguments did not convince Judge Preska, who found instead that 3C is not meant to be a sequel of the original work, but instead deconstructed the television show. As such, it is not a potential market substitution for the original work and the fourth factor thus weighed in favor of fair use. Indeed, the Supreme Court had noted in *Campbell* that parody, as a criticism of the original work, may very well be so successful as to suppress further public demand for the original work.

Judge Preska concluded that *3C* was a fair use of *Three's Company*, as it is "*a highly transformative parody of Three's Company…* [*and*] *a drastic departure from the original that poses little risk to the market for the original*" (SDNY Order p. 55). She concluded that copyright law "*is designed to foster creativity… The law is agnostic between creators and infringers, favoring only creativity and the harvest of knowledge.*"

Intellectual property
United States

Supreme Court holds that TTAB's decisions have preclusive effect on courts

By Marie-Andrée Weiss

Supreme Court trademark cases are quite rare, and so the recent *B&B Hardware, Inc. v. Hargis Industries, Inc.* case has been much discussed. The Supreme Court held that Decisions of the Trademark Trial and Appeal Board (TTAB) have a preclusive effect in subsequent trademark infringement suits if the other ordinary elements of issue preclusion are met; that is, when the usages adjudicated by the TTAB are materially the same as those before the district court.

Recap of the Procedure Described as "Labyrinthine" by the Supreme Court

There are two ways for a trademark owner to prevent another mark to be registered, if he believes there is a likelihood of confusion with his own mark. Under 15 U.S.C. § 1052(d), he may file an opposition to the registration of the junior mark, claiming that it *"so resembles* [*the registered mark*]*… as to be likely, when used on or in connection with the goods of the applicant, to cause confusion, or to cause mistake, or to deceive*." In that case, it is the TTAB which ultimately decides whether there is or is not a likelihood of confusion between the two marks.

A trademark owner may also choose to file a trademark infringement suit in a federal court, under 15 U.S.C. § 1114(1), the infringement provision of the Lanham Act. A registration proceeding and a trademark infringement suit can occur at the same time, which was the case here.

Petitioner B&B Hardware (B&B) and Respondent Hargis Industries, Inc. (Hargis) both manufacture metal fasteners, a product which must seal tightly. They have been litigating for almost twenty years. B&B registered SEALTIGHT as a trademark in 1993. Hargis filed a trademark registration for the SEALTITE trademark in 1996, but the USPTO refused the register the mark because it was confusingly similar with SEALTIGHT.

SEALTITE was published for opposition in 2002 and B&B filed an opposition in February 2003, claiming it was confusingly similar with SEALTIGHT. The TTAB sided with B&B, and Hargis did not seek judicial review of this decision. B&B had also filed a trademark infringement suit against Hargis, but the TTAB published its decision before the District Court ruled on likelihood of confusion. B&B then argued that Hargis could not contest likelihood of confusion because of the preclusive effect of the TTAB decision. The District Court rejected issue preclusion, reasoning that the TTAB is an agency, not an Article III court, that is, a court created by Article III of the U.S. Constitution, which created the federal

courts.

B&B appealed to the Eight Circuit, which affirmed, not on Article III grounds, however, but because the TTAB considers different likelihood of confusion factors than the Eighth Circuit. Indeed, the TTAB use the thirteen *DuPont* factors to evaluate likelihood of confusion, but the Eight Circuit uses the six-factor test from the 1980 *Squirt Co v. Seven-Up Co*. case.

B&B appealed to the Supreme Court, which granted certiorari. On March 24, 2015, the Supreme Court reversed the judgment and remanded it for further proceedings.

The question presented to the Supreme Court was whether the District Court should have considered the issue to be precluded because the TTAB's decision that SEALTITE is confusingly similar to SEALTIGHT.

TTAB is an administrative agency, not a court, but agency decision can ground issue preclusion

The District Court had rejected issue preclusion because the TTB is not an Article III Court. But the Supreme Court disagreed, because the Restatement (Second) of Judgments and several of its own cases "*make clear that issue preclusion is not limited to those situations in which same issue is before* ***two courts*** " (p. 9, emphasis in the text), noting further and that "*where a single issue is before a court and an administrative agency, preclusion also often applies*" (p.9).

The Lanham Act does not forbid issue preclusion

The Supreme Court cited its 1991 *Astoria Fed. Sav. & Loan Assn. v. Solimino* case, which held that issue preclusion is available unless it is "*evident*" that Congress does not want it (*Astoria* at 108). For the Supreme Court, neither the text nor the structure of the Lanham Act forbids issue preclusion, noting that "[*w*]*hat matters here is that registration is not a prerequisite to an infringement action. Rather, it is a separate proceeding to decide separate rights*" (p.14).

The TTAB and the courts apply the same likelihood of confusion standard

The Eighth Circuit had refused to issue preclusion because the TTAB did not use the same factors than the Eighth Circuit to assess likelihood of confusion, reasoning that legal issues are not identical if the second action applies a different legal standard than the first one, even though the facts are the same in both suits.

The Supreme Court cited Professor McCarthy's seminal treaty on trademark law, where he wrote that issue preclusion applies where "*the issues in the two cases are indeed identical and the other rules of collateral estoppels are carefully observed*" (p.15). For the Supreme Court, "*the same likelihood-of-confusion standard applies to both registration and infringement*" (p.15), and the real question is "*whether likelihood of confusion for purposes of registration is the same standard as likelihood of confusion for purposes of*

infringement" (p. 16).

The Supreme Court noted that "*the operative language,"* that is, the registration provision codified at 15 U.S.C. § 1052(d), and the infringement provision codified at 15 U.S.C. § 1114(1) "*is essentially the same.*" Also, the likelihood-of-confusion language used in the Lanham Act "*has been central to trademark registration since at least 1881,*"when the Act of March 3, 1881 used a "*likely to cause confusion*" standard for registration. Finally, "*district courts can cancel registrations during infringement litigation [and] [t]here is no reason to think that the same district judge in the same case should apply two separate standards of likelihood of confusion*"(p. 15-16).

Hargis unsuccessfully argued that the infringement standard in the registration provision of the Lanham Act is whether the marks resemble each other, while the infringement standard in the infringement provisions of the Lanham Act is whether the infringing mark has been used in commerce. But while the Supreme Court found "*some force*" in this argument, as the TTAB only reviews the uses of the mark encompassed in the registration, not actual uses, some of which may not be disclosed, the argument nevertheless fails as this does not mean that the TTAB "*applies a* ***different standard*** *to the usages it considers*" (p. 18, Supreme Court emphasis).

TTAB and court procedures are both of the same quality

The Supreme Court added that "[*n*]*o one disputes that the TTAB and district courts use different procedures*"(p.19). However, "[*p*]*rocedural differences, by themselves… do not defeat issue preclusion*" (p.20). Instead, for the Supreme Court, "*the correct inquiry is whether the procedures used in the first proceeding were fundamentally poor, cursory, or unfair.* As there was no "*categorical reason to doubt the quality, extensiveness, or fairness*" of the TTAB procedure, the argument that registration is incompatible with issue preclusion failed.

Registration action and infringement action are both important

Hargis also argued that, because what is at stake in a registration action is much less important than an infringement action, issue preclusion should never apply to TTA decisions. The Supreme Court disagreed, as registration is an important process with "*substantial*" benefits, such as incontestability of a mark after five years of being registered, and Congress even allowed district courts to review the TTAB decisions *de novo*. Because a district court adjudication has a preclusive effect in another district court, the Supreme Court concluded that it should not be different for unchallenged TTAB decisions.

The Supreme Court instructed the court on remand to apply the following rule: "*So long as the other ordinary elements of issue preclusion are met, when the usages adjudicated by the TTAB are materially the same as those before the district court, issue preclusion should apply*" (p. 22).

Intellectual property

European Union

Case C-463/12 Copydan Båndkopi v. Nokia Danmark A/S

By Nikolaos Theodorakis

On March 5, 2015 the Court of Justice of the European Union ("the Court", "CJEU") ruled in Case C-463/12 Copydan Båndkopi v. Nokia Danmark A/S ('Copydan'). The predominant issue was the private copying exception found in Article 5(2)(b) of Directive 2001/29/EC. Relevant case law includes the decisions on *Padawan*, *Stichting de Thuiskopie*,*Luksan*, *VG Wort*, *Amazon.com* and, *ACI Adam*. Other pending decisions include C-572/13 Hewlett-Packard and C-470/14 Egeda.

Factual background

Nokia Corporation sold mobile phones to business customers in Denmark, who then resold them to individuals and business customers. Nokia phones have, by default, a non-detachable storage device, widely known as internal memory. Certain models also have a detachable memory card; on these cards users can, *inter alia*, store files that might be subject to copyright issues (e.g. films, music, pictures). Detachable memory cards are, therefore, multifunctional media since they can equally be used for private copying and issues unrelated to private copying (e.g. storing personal data). For that purpose, the Danish collecting society,[1] Copydan Båndkopi, claimed that Nokia had to pay a private copying levy from 2004 to 2009, when detachable memory cards that were imported into Denmark were used for mobile phones.

Nokia appealed on multiple grounds and, subsequently, the Danish Eastern Court (Østre Landsret) submitted the case before the CJEU. The topics included in the reference are (i) the admissibility of levies on multifunctional media and on media components, (ii) the detailed arrangements for the charging of the levy, (iii) the possibility of *de minimis* harm, (iv) the impact of rights holders' authorisation on the limitation, (v) the impact of technical protection measures (TPMs), (vi) the unlawful nature of the source of the copy, and (vii) the impact of the use of third party devices for private copying.

Advocate General Villalón issued his opinion in mid-2014, prior to the Court's decision. When addressing the questions, the Court defined the objectives of the 2001/29/EC Directive as found in recitals 9, 10, 31, 32, 35, 38 and 39 in the preamble to the Directive.

Findings

(i) Levies on multifunctional media

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[1] A copyright collecting society is created through copyright law or a private agreement, and focuses on collective rights management. In doing so, it licenses copyrighted works, negotiates future licenses, collects, and distributes royalties.

The first question related to the admissibility of levies on multifunctional media, and the Court followed the AG's view in that the capacity for media to be used for private copying suffices for it to be considered a legitimate levy target. The underlying rationale is that users are in principle taking full advantage of the functions that the medium provides. Yet, the function might affect the compensation since this pertains to the relative importance of the medium's capacity to reproduce works for private use, and in case of negligible copying, the *de minimis* provision might apply.

The next question related to whether only certain detachable memory cards are admissible for levies and not internal memory components of other devices, where both are used for private copying. The Court emphasized the need to address limitations pursuant to the equal treatment principle, noting that different treatment of comparable levy targets must be justified. In other words, a national system cannot differentiate between similar categories of media, except where justified.

(ii) Arrangements for the charging of the levy

The Danish system imposed the levy on producers and importers of mobile phone cards to business customers who then resold them to end users. The Court recognized an exemption for producers/ importers if they can establish that a media was sold to professional entities and for purposes other than private copying.

(iii) De minimis harm

On the issue of *de minimis* harm, the Court recognized that the enjoy discretion when setting the benchmark for what is minimal. This definition must, however, be in concordance with, among other things, the principle of equal treatment (Article 30 of the Charter).

(iv) Rights holders' authorisation and remuneration

With regard to the impact of rights holders' approval, the Court addressed in *VG Wort* that, if an exception covers an end-user, any authorisation by rights holders is irrelevant as for the purposes of fair compensation since they are permissible regardless of authorisation. The Court furthered this doctrine in Copydan, stating that it also applies where a work is made available subject to payment.

(v) Impact of TPMs

The impact that TPMs have on devices on the condition of fair compensation *vis-à-vis* private copies was analysed in accordance with *VG Wort* and *ACI Adam*. TPMs allow rights holders to restrict unauthorised acts and help define the scope of the limitation. Because of their voluntary nature, the condition of fair compensation remains applicable, yet Member States may decide that TPM application has an impact on the level of fair compensation.

(vi) Unlawful sources

The court limited its interpretation of unlawful sources to those made available to the public without the consent of the

rights holders. The Court found the Østre Landsret reference inadmissible since it did not provide sufficient information regarding the nature of the reproductions.

(vii) Third party device used for copying

The final question relates to whether national law that places levies on copies made by an individual through a third party device is compatible with the Directive (e.g. DVDs and CDs made by an individual). The Court, after defining the exception's scope, notes that Article 5(2)(b) makes no reference to such connections and does not relate to the use of third party devices for copies. Overall, national legislation imposing a levy on third party devices used for private copying is compatible with the Directive since the choice to levy these devices is outside the scope of the Directive and thus within the margin of discretion of Member States.

Conclusions

The judgment in *Copydan* overall tackles a breadth of issues related to private copying and levies. It does not depart from previous decisions such as *VG Wort* and *ACI Adam*. Yet, time will tell whether the Court will follow the same train of thought in pending cases, or whether it will redefine the nebulous concepts of unlawful sources and third party devices used for copying, which were not adequately addressed in Copydan.

Intellectual property

European Union

EU Court rules on hyperlinks to live broadcasts on the Internet

By Gabriel M. Lentner

Following the *Svensson* (C-466/12) and *BestWater* (C-348/13) cases, the Court of Justice of the European Union ("CJEU") delivered its judgment on 26 March 2015 in the case of *C More Entertainment AB v. Linus Sandberg* (Case C-279/13). As in previous preliminary rulings, the CJEU had to deal with questions concerning the right of communication to the public in the context of websites providing hyperlinks to content. While the initial request by the Swedish Supreme Court referred five questions to the CJEU, it viewed four as having already been clarified by the CJEU in its previous judgment in *Svensson*, thus leaving only one question to be addressed by the Court.

The case at hand concerned a Swedish pay-TV station, C More Entertainment, which broadcasts live on its website ice hockey matches behind a pay wall. The defendant created links on his website enabling this pay wall to be circumvented, giving free access to Internet users to these live broadcasts. In *Svensson* the CJEU has already held that creating hyperlinks to a copyright work made available on another, freely accessible website does not constitute an 'act of communication to the public' within the meaning of Article 3(1) of the 2001 Copyright Directive. In *BestWater*, the Court clarified that the embedding or framing of a work which is freely available on a publicly accessible website is equally not infringing, unless it is directed at a different audience than originally intended or is communicated by using different technical means.

Following the guidance provided for in *Svensson*, the Swedish Supreme Court held that the hyperlinking to content behind a paywall did infringe the right of communication to the public, since the links gave access to the content to an audience who were not intended to receive it.

It was not clear, however, whether Article 3(2)(d) of the Copyright Directive 2001/29 precluded national legislation from extending the exclusive right of broadcasting organizations to live broadcasts of sporting fixtures on the Internet. The issue arose because the concept of 'communication to the public' refers only to transmissions which members of the public may access at a place *and* at a time individually chosen by them. Accordingly, this does not apply to *live broadcasts* on the Internet. In that regard, the CJEU held that Member States are allowed to provide for more protective provisions relating to broadcasting and communication to the public of

transmissions by broadcasting organizations. According to the Court, Article 3(2)(d) of the Copyright Directive must be interpreted as not precluding national legislation extending the exclusive right of broadcasting organizations referred to in that provision to acts of communication to the public (such as live broadcasts of sporting fixtures on the Internet) provided that such an extension does not undermine the protection of copyright.

As a result, the rights of broadcasting organizations as regards live broadcasts online may vary within the EU, with some Member States offering broader protection such as Sweden or the UK.

Intellectual property

European Union

European Court of Justice: reduced VAT rate cannot be applied to supply of e-books

By Marie-Andrée Weiss

On March 5, 2015, the European Court of Justice (ECJ) held that France and Luxembourg have failed to fulfill their obligations under the Council Directive 2006/112/EC of November 28, 2006 on the common system of value added tax (the VAT Directive), because they had applied, since January 1, 2012 a reduced value added tax (VAT) rate to the supply of digital or electronic books (e-books). The two cases are C-479/13 and C-502/13.

Article 96 of the VAT Directive directs Member States to fix a standard VAT rate, which must be the same for the supply of goods and for the supply of services. Article 14(1) of the Directive defines "*supply of goods*" as "*the transfer of the right to dispose of any tangible property as owner.*" Article 24(1) of the Directive defines "*supply of services*" as "*any transaction which does not constitute a supply of goods.*"

Article 98 of the same Directive allows Member States to apply one or two reduced VAT rates, but only on the goods or services enumerated in Annex III of the Directive, a list which includes books in its point 6. Article 98(2) specifies, however, that these reduced rates cannot be applied to the services referred to in point (k) of Article 56(1) of the Directive, which lists some "*electronically supplied services, such as those referred to in Annex II.*" Annex II of the Directive is an list of the electronically supplied services referred to in point (k) of Article 56(1) and does not list the supply of books among these services, but the list is indicative, not exhaustive.

It should be noted that Directive 2009/47 of May 5, 2009, amending Directive 2006/112/EC as regards reduced rates of value added tax, states in its Recital 4 that the VAT Directive had to be amended "*in order to clarify and update to technical progress the reference to books in its Annex III*" and amends point 6 of Annex III as including "*books on all physical means of support.*"

While it is clear that EU law allows Member States to apply a reduced VAT rate to books, whether they can also apply a reduced VAT rate to e-books is less clear. If their sales are considered a sale of books on electronic support, Member States may apply a reduced VAT rate to the sale. However, if their sale is considered to be the supply of electronic services, then EU law prevents Member States to apply a reduced VAT rate to this service.

France took the position that it can apply a reduced VAT to e-books, as Article 278-a of its General Tax Code provides for a reduced 5.5% VAT rate on books, including

e-books purchased by downloading them. Luxembourg also took the position that a reduced VAT rate should be applied to both books and e-books, noting in a Circular N0. 756 of December 12, 2011, that, while "*there has not been a unanimous interpretation of the notion of "books" in the Member States…, the* [*Luxembourg*] *government has decided, for reasons of neutrality… that no distinction is to be made between physical formats and digital formats, where they are functionally identical*" and decided to apply a 'super-reduced' VAT rate of 3% on e-books as of January 1, 2012.

The European Commission found France and Luxembourg's position to be contrary to the VAT Directive, and sent France and Luxembourg letters of formal notice on July 4, 2012, then issued reasoned opinions on the matter on October 25, 2012, asking France and Luxembourg to comply with its requirements within one month of receipt. As the Commission was not satisfied with their answers, it commenced an infringement action under article 258 of the Treaty on the Functioning of the European Union, against both Member States, claiming that they had not fulfilled their obligations under EU law. Belgium was authorized to intervene in this action in support of France and of Luxembourg.

The Commission's arguments

The Commission argued that applying a reduced VAT rate to the supply of e-books was not compatible with articles 96 and 98 of the VAT Directive, read in conjunction with its Annexes II and III, and Implementing Regulation No. 282/2011, article 7, which states that the "*electronically supplied services*," which cannot benefit from a reduced VAT rate under the VAT Directive "*include services which are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology*." Therefore, for the Commission, the reduced VAT rate cannot apply to the supply of e-books because, while Annex III lists books as goods to which a reduced VAT rate can be applied, e-books are out of the scope of article 98 of the Directive which allows Member States to apply a reduced rate to some goods and services.

France and Luxembourg's arguments

France and Luxembourg argued instead, that, as point 6 of Annex III lists books, it therefore also covers the supply of e-books, and thus a reduced VAT rate can be applied to e-books. Indeed, article 96 of the VAT Directive provides that the VAT rate "*shall be the same for the supply of goods and for the supply of services*." Article 98(1) of the Directive provides Member States with the right to apply a reduced rate, and Annex III lists in its point 6 books as goods which can be taxed at a lower rate.

Supplying e-books is a supply of goods, not a supply of services

The ECJ was not convinced by France and Luxembourg's arguments. It reasoned that, while it is clear that point 6 of Annex III allows the supply of books on a physical

medium to be taxable at a lower rate, it does not include in its scope the supply of electronic books. As this provision is an exception to the general principle that Member States must apply a standard VAT rate, it must therefore be interpreted strictly by the Court (C-479-13 at 30, citing its decision in *Commission v. Spain C-360/11*).

The ECJ noted that the EU legislature had excluded "electronically supplied services" from the scope of article 98(2) authorizing Member States to apply reduced VAT rates to some goods and services, and stated that "*the supply of electronic books is an 'electronically supplied service…' within the meaning of… article 98(2)" (*C-479/13at 34).

The ECJ further reasoned that article 24(1) of the VAT Directive defines supply of services as "*any transaction which does not constitute a supply of goods.*" While France argued that supplying e-books is not a "supply of goods" within the meaning of article 24(1), the ECJ stated that "*the physical support enabling an electronic book to be read, which could quality as 'tangible property', is not part of that supply"* and that, therefore, "*the supply of electronic books must classified as a supply of services*" (C-479/13 at 35).

The ECJ also noted that the supply of electronic books *"clearly meets"* article 7(1) of Implementing Regulation No 282/2011's definition of "*electronically supplied* s*ervices*," noting that point 3 of Annex II, lists" images*, text and information and making available of databases*" as electronically supplied goods which are made outside of the scope of article 98 by point k of article 56(1) of the VAT Directive.

As "*the supply of electronic books is an electronically supplied service within the meaning of the second subparagraph of Article 98(2) of the VAT Directive*," Member States cannot apply to them a reduced VAT rate. For the court, point 6 of Annex III of the VAT Directive applies only to "*a transaction consisting of the supply of a book on a physical medium. … Admittedly, in order to be able to read an electronic book, physical support, such as a computer, is required. However, such support is not included in the supply of electronic books*" (C 502/13 at 35).

Luxembourg has announced it will apply a 17% VAT rate on e-books as of May 1, 2015. But in a joint declaration published on March 19, 2015, the ministers of culture of France, Germany, Italy and Poland ask the European Commission "*to propose without delay an evolution in the European legislation to allow reduced tax rates of VAT for all books whether they are printed or digital*." More developments on the issue are thus expected to follow soon.

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