Against the Grain

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Legally Speaking-An Apple for Authos: Status of United States v. Apple, Inc., et. al

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LEGAL ISSUES

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Legally Speaking — An Apple for Authors

Status of United States v. Apple, Inc. et al.

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Last April, the **U.S. Department of Justice** filed a civil antitrust suit alleging that **Apple, Inc.** and five of the six largest publishers in the United States engaged in a conspiracy to fix the sales price of electronic eBooks in violation of the ***Sherman Antitrust Act***. ***United States v. Apple, Inc. et al.***, 12 Civ. 2826 DLC (S.D.N.Y.). At the same time, the government announced that it had reached a settlement of the case with three of the five publishers: **Hachette Book Group USA**, **HarperCollins Publishers LLC**, and **Simon & Schuster Inc.** This Summer, there was a battle of the briefs over whether the court should approve the settlement. On September 5th, despite public comments that the court described as "both voluminous and overwhelmingly negative," Judge Cote handed down her decision approving the settlement. *See* 2012 U.S. Dist. LEXIS 127034 (S.D.N.Y.).

What's the Case About?

The government's allegation is that publishers felt that their entire business model was threatened when internet bookseller **Amazon** began pricing eBook versions of the publishers' best-sellers at $9.99. The **DOJ** claims that the publishers jointly decided in 2009 to take steps to force **Amazon** to raise its prices by requiring **Amazon** and other retailers to sign an "agency agreement" giving each publisher the right to set the price at which the retailer could resell the publisher's books. (The traditional approach had been the "wholesaler" model in which the publisher sold books to retailers at wholesale and let the bookseller charge whatever it wanted.)

Because the publishers collectively accounted for nearly half of **Amazon's** eBook revenues, the **DOJ** alleges that the publishers recognized that they could jointly exercise power over **Amazon** by threatening to refuse to sell to it unless **Amazon** accepted the publishers' new agency contract and changed its pricing practices. The publishers worked cooperatively with **Apple** to develop the "agency agreement" scheme. **Apple** had wanted to enter the eBook market with its new i-Pad but saw **Amazon's** low prices as a barrier. Each publisher entered into a "most favored nation" (MFN) agreement with **Apple**, promising that no other eBook retailer would be allowed to sell an eBook title at a lower price than **Apple**.

The scheme worked. **Amazon** signed the agency agreements and raised its prices, and **Apple** got into the eBook market via its "iBookstore." When **Apple** launched its iBookstore in April of 2010, the retail prices of many bestselling and newly-released eBooks published in this country jumped 30 to 50 percent virtually overnight (from $9.99 to between $12.99 and $16.99, depending on the hardcover sales price). As a result, according to the **Department of Justice** complaint, "[d]efendants' ongoing conspiracy and agreement have caused eBook consumers to pay tens of millions of dollars more for eBooks than they otherwise would have paid."

What's the Settlement About?

The publishers did not admit to violating the antitrust laws but did agree to the entry of a Final Judgment against them containing several mandatory provisions. Under the settlement with the government, **Hachette**, **HarperCollins**, and **Simon & Schuster** agreed to terminate their agency agreements with **Apple** and other eBooks retailers and will be prohibited for two years from entering into new agreements that constrain retailers' ability to offer discounts or promotions to consumers to encourage the sale of the publishers' eBooks, including agreeing to any MFN terms.

The settlement does not prohibit the publishers from entering into new "agency" agreements with eBook retailers, but those agreements cannot prohibit the retailer from reducing the price set by the publishers. Nor does the settlement prevent the publishers from participating in "output-enhancing" industry standard-setting activities relating to eBook security or technology.

What's the Status?

Pursuant to the so-called ***Tunney Act***, public notice of the proposed settlement and of an opportunity to comment was published in various newspapers and in the Federal Register in April. By the end of the 60-day comment period on June 25, 2012, over 800 comments had been submitted. The commenters included defendant **Apple, Inc.**, the **American Booksellers Association**, the **Author's Guild**, **Barnes & Noble**, the **Consumer Federation of America**, and the **National Association of College Stores**, as well as hundreds of individual authors, agents, and book dealers. About 70 commenters, including the **Consumer Federation**, supported the settlement, and the rest opposed it, including **Apple** and **Barnes & Noble**.

After reviewing the comments, the **Department of Justice** filed its response on July 23rd, concluding that none of the criticisms had merit and that the proposed Final Judgment (embodying the settlement's terms), as drafted, "provides an effective and appropriate remedy for the antitrust violations alleged in the Complaint and is therefore in the public interest."

On September 5, **Judge Cote** concluded that entry of the Final Judgment was appropriate under the Congressionally-enacted guidelines regulating government consent decrees. The court held that:

> By effectively disallowing the Settling Defendants from using the agency model for at least two years, subject to limited exceptions, and from using Price

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MFNs for at least five, the proposed Final Judgment appears reasonably calculated to restore retail price competition to the market for trade eBooks, to return prices to their competitive level, and to benefit eBooks consumers and the public generally, at least as to the competitive harms alleged in the Complaint. [2012 U.S. Dist. LEXIS 127034 at *18.]

What was the Fight About Now?

Those opposing the settlement were generally of the view that the proposed remedy is worse than the malady. They claim that Amazon's $9.95 eBook price amounted to "predatory" pricing by a monopolist intended to drive out any would-be competitors at the retail level and that the current industry equilibrium, even if collusively attained, is preferable to the wide-open marketplace that preceded it.

- The **American Booksellers Association** contends that "elimination of the Agency Model will radically change the current eBook distribution system, will significantly discourage new entry, and will lead to the departure from the market of a sizeable number of the independent bookstores that are currently selling eBooks."
- The **Authors' Guild** argues that **Amazon** is the real enemy who has in the past and will again in the future monopolize the eBook business and thus "[t]he proposed settlement will almost certainly backfire and harm readers in the long run."
- **Apple** flatly states that "[t]he Proposed Judgment is a threat to eBook competition" and will "impose a business model that will result in dramatic and long-lasting harm" to the marketplace.

The bulk of individual commenters tracked the themes (and often the words) in the **Authors' Guild** and **ABA** statements, offering as an overarching theme that lower eBook prices would harm booksellers directly and others indirectly. In addition, a number of individuals took the chance to basically lament the fundamental changes in the publishing world that have been occurring over the past two decades.

The **DOJ's** reaction to these comments was dismissive, if not downright derisive. In the government's view, the critical comments "generally were submitted by those who have an interest in seeing consumers pay more for eBooks, and hobbling retailers that might want to sell eBooks at lower price." The **DOJ's** written response, which runs to some 56 pages. is available at *http://www.justice.gov/atr/cases/f285300/285315.pdf*, and states *inter alia*:

> The United States received many comments that sought to excuse price fixing as necessary to end **Amazon's** reported ninety percent share of the eBook market, and noted that **Apple's** entry effectuated erosion of **Amazon's** share and spurred all sorts of innovations, such as color eBooks. But the reality is that, despite its conspiratorial efforts, **Apple's** entry into the eBook market was not immediately successful. It was, in fact, **Barnes & Noble's** entry — prior to **Apple** — that took significant share away from **Amazon**; and many of the touted innovations were in development long before **Apple** decided to enter the market via conspiracy.

The **DOJ's** response also rejects the claim that it is trying to "impose" a business model on the publishing industry by banning agency agreements. The government maintains that it "does not object to the agency method of distribution in the eBook industry," only to the "collusive use of agency" to eliminate horizontal competition between publishers and between retailers which "thrust[s] higher prices onto consumers."

The government further rejects the argument made by some commenters that it should not and need not bar the settling defendants from using agency agreement (even for the two-year period specified in the settlement). The **DOJ's** response states:

> [A] prohibition on price fixing or the termination of the Apple Agency Agreements standing alone would be insufficient to undo the effects of the conspiracy. By colluding, defendants learned that they shared a common goal to raise eBook prices, agreed to use particular tools to achieve that goal, found those tools to be effective, and found each other reliable in the application of those tools. It is appropriate, therefore, to restrict defendants' ability to use the tools that effectuated the conspiracy.

The two-year limitations, the **DOJ** argued, are "designed not to last long enough to alter the ultimate development of the competitive landscape in the still-evolving eBooks industry." Moreover, the settling publishers may pay for eBook promotion or marketing efforts made by brick-and-mortar booksellers. In addition, the publishers may negotiate a commitment from any eBook retailer to limit its annual discounts, so that each settling defendants may ensure that its entire catalog of eBooks is not sold by any retailer below its total eBook costs.

What did the Court Do?

In her analysis of the criticisms of the proposed settlement, **Judge Cote** largely accepted the government's arguments, but emphasized her recognition of "the importance of books and authors in the quest for human knowledge and creative expression" and quoted **Emily Dickinson** to the effect that "There is no Frigate like a Book/To take us Lands away." *Id.* at *23.

In the end, however, the court rejected the principal criticism leveled by the objectors (that the proposed Final Judgment would impose decimate brick-and-mortar booksellers by permitting **Amazon** to return to its predatory discounting strategy), stating:

> To the extent harm to industry stakeholders like bookstores will result from the elimination of anticompetitive, collusive practices and a return to competition in the eBooks retail market, this is not the type of harm that the ***Sherman Act*** is designed to prevent. * * * What is clear . . . is the need for industry players to play by the antitrust rules when confronted with new market forces. It is not the place of the Court to protect these bookstores and other stakeholders from the vicissitudes of a competitive market. [*Id.* at *26-27.]

The court further observed that "**Amazon's** alleged free-riding in no way justifies subsidizing brick-and-mortar bookstores by virtue of an eBooks price-fixing conspiracy." *Id.* at *28. The court also noted that there was no proof of any antitrust violation by **Amazon** *Id*. at *47-48.

The district court expressed little doubt in approving the proposed Final Judgment. **Judge Cote**, who was a well-respected career prosecutor with the **U.S. Attorney's Office** in New York before taking the bench in 1994, had already ruled in a related private cause of action that the price-fixing charges are not "implausible." In May, **Judge Cote** had denied a motion to dismiss filed by **Apple** and the publishers in the parallel civil class action case which is also pending before her. ***In re Elec. Books Antitrust Litig.***, 2012-1 Trade Cas. (CCH) ¶ 77,889 (S.D.N.Y. 2012). She rejected the defendants' attack on the plausibility of the alleged conspiracy, stating:

> None of these purported deficiencies in the pleading render the CAC's allegations of a price-fixing conspiracy implausible. "The character and effect of a conspiracy are not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole." . . . [T]he Complaint survives the tests imposed by Rule 12(b)(6) and states a Sherman Act violation. [*Id.* at *48.]

In the **DOJ** action, **Judge Cote** was unmoved by the criticisms of the relief in the proposed Final Judgment and saw it — when all was said and done — as merely a garden-variety settlement of a garden-variety price-fixing conspiracy case. The court also rejected **Apple's** request that entry of the Final Judgment be deferred until after the currently-scheduled June 2013 trial on the merits of the government's complaint against **Apple** and the two non-settling defendants (**MacMillan** and **Penguin**), refusing to leave the settling defendants in a "legal limbo."

Endnotes

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