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Legally Speaking: Legal eBooks and Illegal eBooks

William M. Hannay
Schiff Hardin, LLP, whannay@schiffhardin.com

Bruce Strauch
The Citadel, strauchb@citadel.edu

Bryan M. Carson
bryan.carson@wku.edu

Jack Montgomery
Western Kentucky University, jack.montgomery@wku.edu

LEGAL ISSUES

Section Editors: **Bruce Strauch** (The Citadel) <strauchb@citadel.edu>
Bryan M. Carson, J.D., M.I.L.S. (Western Kentucky University) <bryan.carson@wku.edu>
Jack Montgomery (Western Kentucky University) <jack.montgomery@wku.edu>

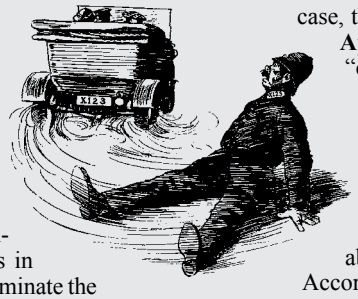
Legally Speaking — Legal eBooks and Illegal eBooks

by **William M. Hannay**[1] (Partner, Schiff Hardin LLP, Chicago) <whannay@schiffhardincom>

The general topic for my contribution to the "Long Arm of the Law" program at the **2013 Charleston Conference** was the continuation of two ongoing epic sagas in the world of digital books: the Apple eBooks price-fixing conspiracy and the Google Books copyright litigation. **Charleston Conference** attendees will perhaps remember my earlier accounts of episodes in these sagas: "Of Books and Competition" in 2010; "Apples and Books or A Gaggle of Googles" in 2011; and "iPad Thai" in 2012. Since the **2012 Charleston Conference** much has happened in the **Apple** and **Google** cases. Let's start with the trial and judgment in ***United States v. Apple***.

U.S. v. Apple, Inc.

As you may recall, in April 2012, the United States Department of Justice filed a civil suit against **Apple** and five of the six largest U.S. publishers alleging violations of the ***Sherman Antitrust Act*** arising from an alleged conspiracy to fix the price of eBooks. On the same day, the DOJ announced an already-negotiated settlement of the case against **Hachette**, **HarperCollins**, and **Simon & Schuster**. Not long thereafter, the attorneys general of 33 states filed their own cases against the defendants, which were joined with the DOJ's suit for pretrial proceedings.



How did this happen? It all started with the explosive success of **Amazon's** Kindle eReader. As more and more publishers started offering eBooks in 2009, **Amazon** sought to dominate the business with a low-price marketing strategy: **Amazon** would retail all eBook bestsellers at $9.99 for use on its Kindle eReader (even if the print version sold for a lot more). Publishers were not happy about this pricing point, and neither was **Apple** which had plans to include an eReader program on its iPad (scheduled to be introduced in 2010) but needed prices to be higher than $9.99 in order to make a profit.

The publishers and **Apple** began meeting in December 2009, and by January 2010 **Apple** had executed individual "agency agreements" with each of the publishers under which **Apple** would act as an "agent" in selling eBooks at a retail price set by the publishers (which were $3 to $5 higher than **Amazon's** $9.99 retail price). In order to make this pricing point work economically, **Amazon** had to be pushed to raise its own prices.

The motivator for this change was a price parity provision in the agency agreements called a Most-Favored-Nation clause ("MFN"). The provision not only protected **Apple** by guaranteeing it could match the lowest retail price listed on any competitor's eBookstore, but also imposed a severe financial penalty upon the publishers if they did not force **Amazon** and other retailers to change their business models and cede control over eBook pricing to the publishers.

When the government sued, the publishers settled out, but **Apple** chose to go to trial. After a three-week trial in June of this year, U.S. District **Judge Denise Cote** — hearing the case as the fact-finder when the parties waived a jury — ruled that **Apple** had in fact conspired to restrain trade in violation of Section 1 of the ***Sherman Act*** and relevant state statutes. ***United States v. Apple, Inc.***, Case 1:12-cv-02826-DLC, Dkt No. 326 (S.D.N.Y.), Opinion, filed July 10, 2013). (Note that, since this was a civil case, rather than a criminal case, the correct terminology is that **Apple** was "found liable," not "convicted.")

The court found that the publishers and **Apple** had "agreed to work together to eliminate retail price competition in the eBook market and raise the price of eBooks above $9.99." Opinion at 11. According to the court, **Apple** was the lynchpin in the conspiracy between and among **Apple** and the publishers: "It provided the Publisher Defendants with the vision, the format, the timetable, and the coordination that they needed to raise eBook prices." *Id*.

Judge Cote found that the MFN clause "eliminated any risk that **Apple** would ever have to compete on price when selling eBooks, while as a practical matter forcing the Publishers to adopt the agency model across the board." Opinion at 48. The MFN clause "literally stiffened the spines of the Publisher Defendants to ensure that they would demand new terms from **Amazon**." *Id*. at 56. And during their negotiations with Amazon, the publishers shared their progress with one another. (The court's written opinion includes a chart of telephone calls between the CEOs of the publishing houses.)

The court concluded that the conspiracy significantly harmed consumers. Since "the laws of supply and demand were not suspended for eBooks," when the publishers increased the prices of their eBooks, they sold fewer books. Opinion at 97. Thus, consumers suffered in a variety of ways from this scheme to eliminate retail price competition and to raise eBook prices: some consumers had to pay more for eBooks; others bought a cheaper eBook rather than the one they preferred to purchase; and still others deferred a purchase altogether rather than pay the higher price. *Id*. at 98.

Analyzing the trial record, **Judge Cote** found that there was "compelling evidence" that **Apple** "conspire[d] with the Publisher Defendants to eliminate retail price competition and to raise eBook prices" and "overwhelming evidence that the Publisher Defendants joined with each other in a horizontal price-fixing conspiracy." Opinion at 113. **Apple** was "a knowing and active member of that conspiracy … not only willingly join[ing] the conspiracy, but also forcefully facilitat[ing] it." *Id.*

In short, "[t]he totality of the evidence leads inextricably to the finding that **Apple** chose to join forces with the Publisher Defendants to raise eBook prices and equipped them with the means to do so." Opinion. at 134-35. **Judge Cote** even quoted **Apple** founder **Steve Jobs'** own words against his company, pointing out that, on the day of the launch of the iPad, **Jobs** told a reporter that "**Amazon's** $9.99 price for [a book newly offered on iPad for $14.99] would be irrelevant because soon all prices will 'be the same.'" *Id*. at 149.[2]

The court subsequently had proceedings to determine what remedy to impose on **Apple**. On September 5, 2013, **Judge Cote** entered a Final Judgment and injunction against **Apple**. The court's order requires **Apple** to modify its existing agreements with the five major publishers with which it conspired — **Hachette Book Group** (USA), **HarperCollins Publishers L.L.C.**, **Holtzbrinck Publishers LLC**, which does business as **Macmillan, Penguin Group (USA) Inc.**, and **Simon & Schuster**

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Inc. — to allow retail price competition and to eliminate the most favored nation pricing clauses that led to higher eBook prices. **Apple** is also prohibited from serving as a conduit of information among the publishers or from retaliating against publishers for refusing to sell eBooks on agency terms. **Apple** is further prohibited from entering into agreements with eBooks publishers that are likely to increase the prices at which **Apple's** competitor retailers may sell that content.

Importantly, **Judge Cote** also granted the government's request to appoint an external "monitor" to ensure that **Apple's** internal antitrust compliance policies will be sufficient to catch future anticompetitive activities before they result in harm to consumers. The monitor — whose salary and expenses will be paid by **Apple** — will work with an internal "antitrust compliance officer" who will be hired by and report exclusively to the outside directors comprising **Apple's** audit committee. (The Department of Justice had initially requested that the monitor have broad powers to block any agreements the company might make to sell any digital content — not just eBooks, but also music, movies, and television shows — that might, in the monitor's view, be likely to increase consumer prices; however, **Judge Cote** granted power only over eBooks to the monitor.)

In October, **Judge Cote** appointed **Michael Bromwich** as the external monitor of **Apple**. The 60-year-old **Bromwich** is an experienced criminal prosecutor and investigator, sort of a "go to" guy for difficult, high-profile assignments. He helped investigate the bombing of Pan Am Flight 103, probed the FBI's conduct in the **Aldrich Ames** spy case, and took over the regulation of offshore drilling after the BP - Deepwater Horizon oil spill. Earlier in his career, he worked on the prosecution of **Col. Oliver North**. To counterbalance **Bromwich's** lack of experience in antitrust matters, he will be assisted by **Bernard Nigro**, the chair of the antitrust department at the NY law firm, **Fried Frank**.

Apple, Inc. continues to maintain its innocence and has recently filed an appeal of **Judge Cote's** orders to the U.S. Court of Appeals for the Second Circuit in New York City. The appeal will probably take a year or more to work its way through the system, but it is not likely that the district court's order will be overturned. The liability finding is based on well-recognized principles of horizontal conspiracy theory and reasonably grounded in the evidence, and the remedy order seems carefully and narrowly drawn to address **Apple's** specific type of misconduct, without over-reaching into other areas of **Apple's** business (as the government had wanted).

A more interesting question is whether the enforcement action against **Apple** and the publishers will meaningfully benefit either consumers or libraries. For consumers, the prices of bestsellers in eBook format appear to have stabilized at levels lower than those prevailing during the time of the conspiracy, but are about 15-20% higher than **Amazon's** $9.99 price point in 2009. For example, **John Grisham's** *Sycamore Row* sells for $11.99, regardless of whether you order it as a NOOK Book, Kindle edition, or from the **Apple** iBookstore.[3] And there are potential damage claims to be paid by **Apple** and the publishers: the five publishers have already settled the states' claims against them for $166 Million in damages. (Their settlement with the DOJ involved only injunctive relief.) **Judge Cote** has scheduled a trial of **Apple** for May 2014 to determine the damages that it will have to pay the states and private plaintiffs as a result of its eBook price-fixing. The amount of overcharges — which would be trebled under the antitrust laws — could total hundreds of millions of dollars in damages.

For libraries, the question of whether the ***Apple*** case has been or will be of any benefit is more complex. As some of the programs offered at the **2013 Charleston Conference** illustrated, publishers have made life difficult for libraries that wish to make eBooks available to patrons or researchers. Some publishers refuse to publish a lendable eBook version of their titles, and those that do offer a lendable one impose high license fees (you can't "buy" the book) and also various restrictions on circulation. If you buy *Sycamore Row* for

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your personal Nook or Kindle, it will cost you $11.99, but if you want a lendable version for the public library, you will probably pay eight times that amount (assuming that **Doubleday** will lease you one).

Why do publishers seem so determined to make it hard for libraries to lend eBooks? I bet it has something to do with money, eh? Publishers probably think they will "sell" more eBooks to individuals if folks can't click on their local library's Website and download a copy of the book for free. Is it legal for publishers to impose high prices and burdensome lending rules on libraries? Probably, unless it turns out that publishers have been talking to each other about their eBook marketing strategies for libraries in the same way that they appear to have had consultations about working with Apple on prices to individuals. Personally, I don't know whether any such conversations between publishers ever took place regarding libraries, but it would present a potential antitrust violation if they did. Otherwise it becomes a matter of either Congressional action (not likely) or jawboning between publishers and their library customers (more likely).[4]

Google Books

Turning to the long-running battle between authors and **Google** over the **Google Books Project**, the marathon has entered its eighth year of combat. As **Charleston Conference** attendees will recall from my prior reports, in 2005, a number of authors and publishers brought a class action and related litigation in Federal court in New York City, charging **Google** with copyright infringement arising from **Google's** agreements with several major research libraries to digitally copy books and other writings in their collections. (Since 2004, **Google** has reportedly scanned some 20 million books.) It has delivered digital copies to the participating libraries, created an electronic database of books, and made text available for online searching. The **Google Books Project** and its "digital library" has been hailed as a boon to schools, scholars, and students, making all books — especially out-of-print works — available to the world.

The authors and publishers had a rather different view of **Google Books** and sought both damages and injunctive relief from the court. **Google's** principal defense was "fair use" under §107 of the ***Copyright Act***. The district court, however, has not yet ruled on the fair use issue; instead, the case has been sidetracked in two separate (unsuccessful) settlement efforts and various procedureal disputes.

Google and the parties suing it (particularly the **Authors Guild**) tried to settle the case in 2008 and again in 2010. However, after numerous objections, extensive briefing, and lengthy oral arguments, the District Court held that the amended settlement agreement was not "fair, adequate, and reasonable" and rejected it. See ***Authors Guild v. Google, Inc.***, 770 F. Supp. 2d 666 (S.D.N.Y., filed March 14, 2011).

In an effort to put the case back on track, attorneys for the **Authors Guild** filed a motion for class certification under Rule 23(b)(3) on December 12, 2011. After briefing and hearings, **Judge Chin** granted the motion on May 31, 2012. See 282 F.R.D. 384 (S.D.N.Y. 2012). **Google** appealed. On May 8, 2013 the U.S Court of Appeals for the Second Circuit heard oral argument and on July 1, 2013, issued an unusually brief opinion reversing **Judge Chin's** grant of class certification on the ground that certification was "premature" and should await further proceedings on **Google's** fair use defense. See ***Google Inc. v. Authors Guild Inc.***, 721 F.3d 132 (2d Cir 2013). The Court of Appeals stated:

> Putting aside the merits of **Google's** claim that plaintiffs are not representative of the certified class — an argument which, in our view, may carry some force — we believe that the resolution of **Google's** fair use defense in the first instance will necessarily inform and perhaps moot our analysis of many class certification issues, including those regarding the commonality of plaintiffs' injuries, the typicality of their claims, and the predominance of common questions of law or fact. Moreover, we are persuaded that holding the issue of class certification in abeyance until **Google's** fair use defense has been resolved will not prejudice the interests of either party during the projected proceedings before the District Court following remand. 721 F.3d at 134.

Thus, the question of whether it is "fair use" to electronically copy millions of copyrighted works has now resumed centerstage in the **Google Books** case.

Judge Chin wasted little time in moving forward with consideration of the fair use defense. After the parties submitted legal briefs, the court heard oral argument on September 23, 2013. While it is notoriously unreliable to divine which way the case will come out from the give and take of oral argument, at least one court watcher concluded that the judge was definitely leaning towards **Google**.[5] **Judge Chin** appeared to find the decision by his fellow judge **Harold Baer** in the ***HathiTrust*** case to be controlling.

In that case, **Judge Baer** of the U.S. District Court in New York City was faced with the obverse side of the ***Google Books*** case. It involves the same copying of millions of books by **Google**, but the case looked at that conduct from the viewpoint of the *libraries* that received from **Google** and, in turn, made available the digitized books to their patrons. The district court granted summary judgment in favor of the libraries in October 2012. See ***Authors Guild, Inc. v. HathiTrust***, 902 F. Supp. 2d 445 (S.D.N.Y. 2012). The court read Second Circuit law to hold that, where the use of the copied work is for scholarship and research, the analysis "tilt[s] in the defendants' favor." Moreover, the court viewed the copying as fair use because it was "transformative." **Judge Baer** held that:

> The use to which the works in the [HathiTrust Digital Library] are put is transformative because the copies serve an entirely different purpose than the original works: the purpose is superior search capabilities rather than actual access to copyrighted material. The search capabilities of the HDL have already given rise to new methods of academic inquiry such as text mining. [*Id.* at 460.]

Judge Baer therefore dismissed the **Authors Guild's** complaint against the libraries.

During oral argument in the ***Google*** case, **Judge Chin** drew attention to **Judge Baer's** conclusion that the library copies in the ***HathiTrust*** case were fair use and asked counsel for the **Authors Guild** whether the court was not in fact bound by that ruling. **Judge Chin** pointed to ways in which **Google Books** has improved research and enabled new kinds of research, such as data mining. (He noted that his law clerks use **Google Books** to do cite checks.) He asked whether these uses are not "transformative." Counsel for the **Authors Guild** countered by focusing the court's attention on **Google's** motivations, which were commercial, not exploratory. He also pointed out that the **Authors Guild** has appealed the ***HathiTrust*** decision to the Second Circuit.

It is hard to predict whether the appellate court will agree with **Judge Baer's** admittedly unprecedented application of the concept of "transformation" in ***HathiTrust*** to permit copying of the complete text of millions of books. **Judge Chin** seemed to take a harder line when he rejected the proposed **Google Books** settlement in 2011. At that time, he flatly declared: "**Google** engaged in wholesale, blatant copying, without first obtaining copyright permissions." 770 F. Supp. at 679. Now he seems to have changed his tune.

It is hard to accept the proposition of **Judge Baer** (and perhaps of **Judge Chin**) that the ease of electronic searching of scanned documents is legally "transformative." Research for centuries has been done by human beings reviewing the text of books and documents, looking for words or names or ideas. The fact that a computer can perform that search process faster does not, it seems to me, transform the process into something so different as to allow an unauthorized party to ignore the copyrights of the original authors and publishers. Copying millions of books and storing them in a searchable database may indeed be a useful thing for the world, but defending that copying on the ground that it is for the public good strikes me as little more than a "Robin Hood" defense, in which stealing from "rich" authors is justified on the ground that the proceed are being given to "poor" academics. Is that really a "fair" use?

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*After the presentation of this paper at the **2013 Charleston Conference**, **Judge Chin** issued a short opinion on November 14, 2013, finally putting the **Google Books** case to rest. He seized on **Judge Baer's** concept of "transformative" use as "fair use" and applied it to **Google** itself, dismissing the authors' complaint against **Google**. This sets the stage for the Second Circuit Court of Appeals to deal with both **HathiTrust** and **Google Books** at the same time. A more detailed discussion of **Judge Chin's** decision was published in the December 13 - January 14 issue of **Against the Grain** (p.41). — **WMH***

Endnotes

1. **Bill Hannay** is a partner in the Chicago-based law firm, **Schiff Hardin LLP**, and an Adjunct Professor at **IIT/Chicago-Kent College of Law**. He is a frequent speaker at the **Charleston Conference** and the author of nine books on antitrust and trade regulation.

2. For a fascinating collection of excerpts from **Steve Jobs'** email introduced as evidence in the case, see **Zachary Seward**, *http://www.theatlantic.com/business/archive/2013/05/the-steve-jobs-emails-that-show-how-to-win-a-hard-nosed-negotiation/276136/*.

3. Changes in the marketplace itself may bring procompetitive effects as well. For example, in October, **Accenture** announced that it has built and will operate an end-to-end e-commerce and direct-to-consumer distribution solution for **HarperCollins Publishers** eBooks globally. The project commenced with the launch of **HarperCollins'** *www.CSLewis.com* and *www.Narnia.com*. See *http://newsroom.accenture.com/news/accenture-to-create-global-e-book-fulfillment-platform-for-harpercollins.htm*.

4. For example, in response to member concerns, the Digital Content & Libraries Working Group of the **American Library Association** has focused on influencing the so-called "Big 6" trade publishers to sell eBooks to libraries on reasonable terms. See *Ebook Business Models for Public Libraries* (August 2012), *http://www.americanlibrariesmagazine.org/blog/ala-releases-%E2%80%9Cebook-business-models-public-libraries%E2%80%9D*.

5. See **Andrew Albanese**, *Publishers Weekly*, Sep. 24, 2013, *http://www.publishersweekly.com/pw/by-topic/digital/copyright/article/59222-after-quick-hearing-google-books-case-appears-ready-to-be-decided.html*.

Questions & Answers — Copyright Column

Column Editor: **Laura N. Gasaway** (Associate Dean for Academic Affairs, University of North Carolina-Chapel Hill School of Law, Chapel Hill, NC 27599; Phone: 919-962-2295; Fax: 919-962-1193) <laura_gasaway@unc.edu> *www.unc.edu/~unclng/gasaway.htm*

QUESTION: A university librarian asks whether it is permissible to provide copies of articles to distance education students who received an incomplete in courses from a previous term, but who now want to complete the course. They are not currently enrolled at the university.

ANSWER: At the request of a user, libraries that meet the ***Copyright Act's*** Section 108(a) requirements are permitted to make single copies of articles for users under Section 108(d), but only one article per journal issue. There is no requirement that the user be enrolled in the institution in order for the library to take advantage of this exception. The library must have no notice that the copy distributed to the user will be used for other than fair use purposes. Further, the library must have provided the required warning to the user.

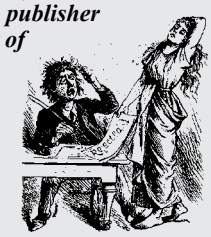
If the articles come from a licensed database, however, the terms of the license agreement apply. Such licenses typically restrict access and copies to enrolled students, faculty, and staff. Thus, providing copies from the database to a non-enrolled student would likely violate the agreement.

QUESTION: An elementary school teacher asks whether there is a maximum number of students who can view a video in conjunction with an educational unit. May more than one class see the video at the same time?

ANSWER: There is no maximum number of students who may view a video in a class session. Section 110(1) of the ***Copyright Act*** permits the performance of an audiovisual work in the course of face-to-face teaching in a nonprofit educational institution. In order to qualify for this exception, the following requirements must be met: (1) students and teachers must be simultaneously present in the same place; (2) no members of the public may be present; (3) the performance must occur in a classroom or other place normally devoted to instruction; (4) the performance must be part of instruction; and (5) the copy of the work that is performed must be a lawfully made copy.

Having more than one class present in the room to see the video is not a problem as long as teachers and students are present. If the performance is for entertainment as opposed to instruction, then a public performance license is required. The **Motion Picture Licensing Corporation** (*http://www.mplc.org/*) and **Swank Motion Pictures Inc.** (*http://www.swank.com/*) offer public performance licenses for motion pictures and videos.

QUESTION: An academic library has a license to an online journal, but the publisher embargoes the most recent 18 months of the publication. For articles within that time period, only citations are available. If the library makes interlibrary loan requests for articles for faculty members via ILL within that 18 month period, must it pay copyright fees after the fifth request? Or does the library have a current subscription to that journal within the meaning of the Interlibrary Loan Guidelines?



ANSWER: This question is likely to be asked with increasing frequency as more journals are available electronically and libraries migrate their subscriptions from print to digital access. The Interlibrary Loan Guidelines were developed by the Commission on the New Technological Users of Copyrighted Works (CONTU) at the request of Congress in 1978 and were published in the conference report that accompanied the ***Copyright Act of 1976***.[1] They are silent at to this issue, but if the subscription was for the printed journal to which the library has a current subscription, requests for missing articles or even embargoed ones beyond the suggestion of five would be treated as a current subscription.

With an online subscription, the publisher likely would say that ILL fees must be paid beyond the suggestion of five for articles published during the 18 month embargo. There is also a strong argument that the library has a current subscription, however. If the license agreement for the journal is silent as to this issue, ILL requests beyond the five can be treated as covered by the current subscription.

QUESTION: A college librarian was asked by two psychology professors about using a purchased Webinar in their classes. The professors purchased a membership in order to obtain access to the Webinar and assumed that they were buying a downloadable Webinar which they could share with their students. What they actually received was access with an account and a password. Since they purchased access, the professors asked whether they may "reformat" the Webinar by downloading it to a DVD to permit showing it to classes since they purchased access.

ANSWER: Unfortunately, the answer is no. It appears that the professors simply acquired access for a single user although the membership for access should have been a clue. Their mistake in what they were acquiring is a shame, but they most likely signed (or clicked on) a license agreement and they are actually bound by the actual terms of the contract. Downloading the Webinar to a DVD and showing it to a class would violate the terms of the agreement. They should contract the publisher and seek the permission they need. It could be that the publisher will grant this permission without charge, and the professors and the institution will have the comfort of knowing they are not violating the contract.

QUESTION: A public librarian asks about a local historian-author who wants to use some very old photographs of the city of Chiefland, Florida, which hang in one of the branch libraries. The photos are quite

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