The never ending story

After the court throws the ebook at Apple, Robins, Kaplan, Miller & Ciresi's **Ryan W Marth** and **Hillel I Parness** question what lessons can be learnt

On 10 July 2013, US district judge Denise Cote issued her lengthy opinion and order in *US v Penguin Group*, the government's antitrust case against Apple, and five of the 'big six' US book publishers, following the government's trial against Apple, (the publishers having settled previously).

Ruling that "Apple participated in and facilitated a horizontal price-fixing conspiracy" and "proven a per se violation of the Sherman Act",[1] the court was unwavering in its conclusion that Apple had violated the antitrust laws, via its successful effort to enter into agreements with the major publishers that resulted in a horizontal conspiracy among the publishers.

This dispute will almost certainly continue, first through a trial to determine damages, followed most likely by appeals of the court's decisions, and also through the pending class action cases against Apple and the publishers. Even at this stage, however, important lessons can be drawn from the court's decision.

Case background

The government commenced its antitrust case against Apple in April 2012, and discovery concluded in March 2013.[2] In September 2012, the court approved a settlement with three of the five defendant publishers. The settlement, which came on the heels of a financial settlement between those publishers and the states, required the publishers to change their business practices and unwind the contracts through which it was alleged the conspiracy had come about. The court explained that this was an appropriate outcome in view of the factual allegations. The two remaining publisher defendants later settled, as well, and the government went to trial against Apple in June 2013.

The opinion

In the 10 July opinion, the court provided an extensive recitation of her factual findings, followed by her legal analysis, and finally her responses to Apple's arguments.

The facts play a pivotal role in the opinion, as reflected in the opening sentence, "This opinion explains how and why the prices for many electronic books, or 'ebooks', rose significantly in the US in April 2010."

The court later summarised the facts as follows, "The plaintiffs have shown that the publisher defendants conspired with each other to eliminate retail price competition in order to raise ebook prices, and that Apple played a central role in facilitating and executing that conspiracy. Without Apple's orchestration of this conspiracy, it would not have succeeded as it did in the Spring of 2010."

According to the court, the facts show that:

- The publishers had agreements with Amazon (termed 'wholesale' agreements), that allowed Amazon to set prices for ebooks, and that Amazon had set prices at $9.99.
- Before Apple's involvement, the publishers had engaged in "windowing" – delaying releases of ebooks in order to preserve hardcover book sales – but found that this approach was detrimental to sales.
- Apple began to meet with the publishers in December 2009, in advance of its planned launch of the iPad in January 2010, with the aim of having a digital bookstore in place in time for the product launch.
- The publishers told Apple they wanted ebook prices to be higher, and Apple told the publishers it was willing to work with them to raise prices, and suggested the price points of $12.99 and $14.99.
- Apple presented the publishers with 'agency' agreements, which allowed the publishers to choose the prices for their ebooks. The agreements included price caps of $12.99 and $14.99 for different types of books.
- The agency agreements also had most-favoured-nation (MFN) clauses, allowing Apple to drop ebook prices to match those in any competitor's digital bookstore.
- The effect of the agency agreements was a substantial upward shift in ebook prices, "virtually overnight", through a coordinated effort by the publishers to change their relationships with Amazon.
- At the iPad launch, Apple's Steve Jobs told reporters that in the future, prices on the Apple iBookstore and on Amazon "will be the same", and that publishers were withholding their books from Amazon.

As the court explained, the caps and MFN clauses in the agency agreements were designed to, and had the effect of, raising prices. Putting it another way, the court explained that "[t]o change the price of ebooks across the industry… the publishers would have to raise Amazon's prices", and the MFN clause "literally stiffened the spines of the publisher defendants to ensure that they would demand new terms from Amazon", and "protected Apple from retail price competition as it punished a publisher if it failed to impose agency terms on other etailers".

In assessing this case, one should not overlook that the court was particularly critical of Apple's presentation of its case. For example, the court called into question the credibility of Apple's witnesses on multiple occasions, also calling them "unreliable" and "less than forthcoming". The court gave little weight to Apple's experts, writing that they "did not offer any scientifically sound analysis of the cause for this purported price decline or seek to control for the factors that may have led to it". Further, the court also found that Apple's defence "somewhat shifted over time", abandoning each of the arguments presented during its opening statement.

When it applied the law to the facts, the court quickly and definitively reached the conclusion that Apple had engaged in a "*per se*" violation of the antitrust laws – a clear violation that need not be assessed under the "rule of reason" standard. According to

the court, "[t]here is little dispute that the publisher defendants conspired together to raise the prices of their ebooks", and that "[t] his price-fixing conspiracy would not have succeeded without the active facilitation and encouragement of Apple". The MFN clauses, the court explained, played an important role, "Apple included the MFN, or price parity provision, in its agreements both to protect itself against any retail price competition and to ensure that it had no retail price competition. Apple fully understood and intended that the MFN would lead the publisher defendants inexorably to demand that Amazon switch to an agency relationship with each of them… Because of the MFN, Apple concluded that it did not need to include as an explicit term in its agreements a demand that a publisher defendant move all of its resellers to agency. The MFN was sufficient to force the change in model."

Even if the evidence did not support a per se violation, wrote the court, the case would come out the same under the rule of reason standard, because Apple cannot show any pro-competitive effect of the publisher agreements.

The court then assessed and rejected each of Apple's defences:

- The Supreme Court's 1984 *Monsanto* decision does not help Apple because Apple cannot demonstrate legitimate business reasons for its actions, and it is not even a close call, but a clear conclusion "based on powerful direct evidence corroborated by compelling circumstantial evidence".
- Apple argued that it did not share the same intent as the publishers – that Apple did not share the desire to raise ebook prices but rather find a way to enter the marketplace. The court said that Apple recognised the publishers' interest and "[a] meeting of the minds to raise ebook prices by working together could not be more clear on this record".
- The court also did not find credible Apple's argument that but for the agency agreements, the publishers would have withheld their books under 'windowing' arrangements, "Viewed from any perspective, Apple's conduct led to higher consumer prices for ebooks".
- As described by the court, Apple "offered a counter-narrative", arguing "that the trial record shows that Apple acted independently and as a lawful participant in a series of negotiations that would be unexceptional for any new market entrant". Unsurprisingly based on the court's recitation of the evidence, this was rejected as well.
- Apple argued that per se liability is inapplicable, as it was not part of the publishers' horizontal conspiracy, but rather stood apart from them in the position of a vertical player. The court rejected this argument because "Apple directly participated in a horizontal price-fixing conspiracy", and thus "its conduct is per se unlawful".
- Finally, the court rejected Apple's argument that a finding of liability would set a "dangerous precedent". While the court said it was "not entirely clear" what Apple was arguing, it took the opportunity to clarify that it was criticising Apple's behaviour, not the particular contractual provisions it chose to use.

The court said, "If Apple is suggesting that an adverse ruling necessarily implies that agency agreements, pricing tiers with caps, MFN clauses, or simultaneous negotiations with suppliers are improper, it is wrong. As explained above, the plaintiffs have not argued and this court has not found that any of these or other such components of Apple's entry into the market were wrongful, either alone or in combination. What was wrongful was the use of those components to facilitate a conspiracy with the publisher defendants."

With that, the court concluded that by the preponderance of evidence, "Apple conspired to restrain trade in violation of Section 1 of the Sherman Act and relevant state statutes", indicating that the next steps would be to address the injunctive relief and damages sought by plaintiffs.

Lessons

The cases against Apple are almost certainly nowhere near their end, but even at this stage we can make a number of observations about the case, and what it can teach both outside and in-house counsel.

1) Remember that whether particular provisions are or are not permitted or enforceable in the relevant jurisdiction is not the only question you must ask. As demonstrated in the *Apple* decision, judges can and do find that acceptable and even commonplace contractual terms can be used as vehicles to violate the law.
2) Accepting your business people's reasons for engaging in an innovative new strategy can be risky, especially when other companies are involved. Consider whether your company's proposed strategy could raise prices or impact a rival's sales. The court saw past Apple's justifications and recognised a purposeful scheme to impact book prices, irrespective of whether Apple cared whether prices changed, (the court said the evidence on this point was "equivocal").
3) The *Apple* court went out of its way to state several times that it was not saying that most-favoured nations clauses and price caps were illegal, but rather the manner in which Apple wielded them was improper. Nevertheless, in view of the obvious impact that MFN clauses and other contractual provisions referencing rivals can have upon competitors, as well as the increased scrutiny that they have received in connection with this case and more generally, in-house counsel would do well to pay special attention to these types of clauses going forward.
4) Even if your company is in an 'upstream' or 'vertical' position relative to a market (eg, a licensor or a distributor), teach your colleagues to avoid talking to any one market participant about your contract terms with others in that market. It has been suggested that the *Apple* case represents a split among the federal circuit courts over the question of whether the per se analysis can be applied to parties who are not part of a horizontal conspiracy, and this is likely to be one of the key issues on appeal. In the meantime, it is best to proceed with due caution.

Footnotes

1. *US v Penguin Group*, 12 Civ 2826 (DLC), 12 Civ 3394 (DLC), 2013 US Dist LEXIS 96424, *141 (SDNY 10 July 2013).
2. This opinion was issued in the cases brought by the federal government and a number of states. There are separate cases brought by private plaintiffs, and brought by the states as parens patriae.

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