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The Proposed Google Book Settlement: Assessing Exclusionary Effects

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I. INTRODUCTION

IN 2002, following becoming the premier Internet search engine, Google began to investigate the possibility of digitizing and adding the universe of books to where it could direct searchers.² This led to the proposals to digitize the collections of some leading university libraries (Harvard, Michigan, Oxford, Stanford). Agreements with a number of publishers to join this program led to the creation of Google Print, later renamed Google Books. The situation did not remain so rosy. In 2005, a number of other prominent publishers sued Google, claiming that digitization of their books and making excerpts available online in response to searches violated their copyrights “on a massive scale.”³ Google’s response was that such activities were “fair use” under U.S. copyright law.⁴

The issue was not resolved through litigation. Instead, Google negotiated a class settlement with the Association of American Publishers and four other publishers representing the “Publisher sub-class” and the Authors Guild of America, representing the “Author Sub-Class.”⁵ The 141 page settlement gave Google the right to: create and sell subscriptions to a database of books; show previews of book pages; sell individual books; and place advertisements in displays of online pages. In turn, Google agreed to turn over 63 percent of the revenues and data regarding use and sales to a “Registry” that would distribute the funds to copyright holders. None of these agreements gives Google exclusive rights; copyright holders and the Registry itself remain free to authorize others to digitize and make available online

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² Google, Inc., at <http://books.google.com/intl/en/googlebooks/history.html>. Here and throughout this essay, I assume the facts and history are not disputed, although the legal interpretations and competitive effects are certainly controversial.

³ Electronic Privacy Information Center (EPIC), *Google Books Settlement and Privacy*, available at <http://epic.org/privacy/googlebooks/default.html#topnews>.

⁴ *Id.*, 17 U.S.C. §107. In U.S. copyright law, the doctrine permits access without infringement “for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research.” In granting fair use, courts are supposed to consider “whether such use is of a commercial nature or is for nonprofit educational purposes ... the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and the effect of the use upon the potential market for or value of the copyrighted work.”

⁵ Settlement Agreement, *The Authors Guild, Inc., Association of American Publishers, Inc., et al., v. Google Inc.*, Case No. 05 CV 8136-JES, (S.D.N.Y.) (Oct. 28, 2008), available at http://www.googlebooksettlement.com/r/view_settlement_agreement.

copies of books to other distributors, including offering exactly the same terms as those obtained by Google.⁶

This proposed settlement has attracted a great deal of antitrust attention because of a confluence of obvious reasons. Google is to the current decade as Microsoft was to the prior decade—the elephant in the information technology zoo that everyone is keeping its eye on. Like Microsoft, Google is not shy about its ambition to become the leading provider in its market. In at least one respect—turning its brand into a verb, “to google,” it has already exceeded Microsoft’s impressive achievements.

But this matter has even more facets. Google’s actions in this matter, and perhaps others (e.g., interlocking directorates),⁷ are taking place against a backdrop of the promise from the Obama administration’s antitrust authorities to give single-firm conduct the attention they believe it deserved but did not get during the prior administration. The leading indicator of this changed attitude is Antitrust Division’s decision to withdraw, as too lax, the Department of Justice’s report on how to assess the competitive effects of single-firm conduct.⁸ If that was not enough, the Google Books matter also brings to mind the increasing importance in an information-based economy of intellectual property—in this case copyright—and the tension many perceive between the exclusivity of IP and the openness of competition. Closely related to that point is the substitution of digital content delivery for traditional hard-copy based methods; a development affecting not just books but audio recordings, newspapers, and films.

The controversies surrounding the Google Books settlement are not limited to antitrust. Some observers are concerned with the privacy implications of Google’s acquiring information on who is looking for which set of books.⁹ As noted briefly below, the proposed settlement raises questions about establishing a class and designing settlements that establish future practices as opposed to distributing compensation for prior wrongs. Copyright law itself is obviously implicated, as this case is a copyright case, not a competition case; whether Google would prevail on a claim that its digitization and preview practices would be “fair use” remains controversial.¹⁰ Economics can be brought to bear on whether a specific use of a copyrighted

⁶ The Settlement also specifies procedures for use, reprinting, and circulation of digital copies by libraries that independently sign agreements with Google as “Fully Participating” or “Cooperating” libraries. These provisions are undoubtedly important, particularly to the library community, but I will not be discussing them here.

⁷ Federal Trade Commission, *Statement of Bureau of Competition Director Richard Feinstein Regarding the Announcement that Google CEO Eric Schmidt Has Resigned from Apple’s Board*, (Aug. 3, 2009), available at <http://www.ftc.gov/opa/2009/08/googlestmt.shtm>.

⁸ U.S. Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act* (Sep. 2008), (still) available at <http://www.usdoj.gov/atr/public/reports/236681.pdf>; U.S. Department of Justice, *Justice Department Withdraws Report on Antitrust Monopoly Law*, (May 11, 2009), available at http://www.usdoj.gov/atr/public/press_releases/2009/245710.pdf. This decision was the subject of an electronic symposium originally posted on truthinmarket.com, much of which was reproduced in the August, 2009 issue of *Global Competition Policy*.

⁹ EPIC, *supra* note 2, available at <http://epic.org/privacy/googlebooks/default.html#privacy>.

¹⁰ Mark A. Lemley, *An Antitrust Assessment of the Google Book Search Settlement*, (July 8, 2009) at 7-8. Available at SSRN: <http://ssrn.com/abstract=1431555>. Lemley states, “The reader should be aware that I represent and have been

work should be considered “fair,” i.e., made available under a free compulsory license, essentially by asking for which uses are the costs of negotiating an agreement likely to exceed the economic benefits to the parties of setting and enforcing a positive price.¹¹

Competition policy rather than privacy or copyright will be the primary focus here. Following is a review of some of the assertions regarding the anticompetitive effects of the Google Book settlement. Because of the stakes, the assertions have led to responses from leading commentators regarding the benefits of the settlement and contesting claims regarding entry barriers. After presenting some of those responses, this article concludes with a look at the broader competition policy and property law implications of this already complex case.

II. ASSERTIONS

The most appropriate place to look for antitrust concerns would be in a recent Statement of Interest (“SOI”) submitted by the U.S. Department of Justice (DOJ) to the court with jurisdiction over the proposed settlement.¹² The SOI begins with “concerns about the adequacy of representation for absent class members”— somewhat ironic in light of DOJ’s antitrust concerns about limiting competition among those class members. Specifically, DOJ states that there is “a significant possibility that the Department will conclude that [the settlement’s] terms violate the federal antitrust laws” as illegal price fixing by copyright holders. In addition, the Division finds that the settlement would foreclose entry by other potential digital book distributors.

This alleged price fixing is manifested in three respects: collective agreement on the revenue Google pays from digital book distribution, prohibitions on retail discounting, and setting prices for “orphan” books—books still under copyright but where the copyright holder cannot be found. With regard to the collective agreement issue, DOJ suggests that the agreement establishes Google as a retail sales agent for digital books; sets a distribution of prices at which it will make books available under the agreement (which rights holders can override); and reduces competition among publishers at the wholesale level to sell to Google. With respect to prohibitions on discounting, DOJ specifically cites the agreement’s requirement that Google can discount prices up to 40 percent but only with the permission of the rights holder. It also objects to a “most favored nation” (“MFN”) clause that “discourages potential competitors (including those sponsored by rights holders) from attempting to follow Google into digital-book distribution because it could not obtain better terms than Google.”

These two issues together lead to DOJ’s problems with the orphan book provisions. As there is no rightsholder who can seek out alternative digital distributors for orphan books, the agreement allegedly allows known rightsholders, through Google, to fix the price of orphan books, thereby reducing competition from them. Randal Picker, in his criticism of the

compensated by Google in the case and settlement I analyze here, and that my wife is employed by Google, so I am not an unbiased observer.”

¹¹ Timothy Brennan, *Harper & Row v. The Nation: Copyrightability and Fair Use*, 33 J. COPYRIGHT SOCIETY U.S.A. 368-89 (1986).

¹² <http://www.usdoj.gov/atr/cases/f250100/250180.pdf>.

settlement, emphasizes this last point, because only the settlement gives Google this right to set the prices and terms of distribution for orphan works.¹³ Since orphan rightsholders by definition cannot be found, they cannot opt out of the settlement. DOJ also argues that because the Registry instituted under the settlement could not offer orphan book rights to competitors to Google, the settlement agreement forecloses competition in the market for the book database service Google would be providing.¹⁴

III. RESPONSES

Much of the recent if not entirely disinterested commentary involves responses to these claims regarding orphan books. Mark Lemley¹⁵ concedes that the settlement could make Google the sole provider of orphan books. However, he argues that to the extent Google remains the sole provider because others find it too expensive to duplicate its efforts to digitize millions of books and create and maintain a database of their content, it has not run afoul of the antitrust laws. Even if one was to construe Google as not just a natural monopoly but a culpable monopolist, the alternative to having Google provide access to out-of-print, orphan books is that these books would not be available at all except for libraries that happen to have physical copies in their collections. Lemley also points to the non-exclusivity of the provisions in the agreement, claiming that on the day the settlement goes into effect, the Registry “could do a deal with Amazon on better terms than Google gets.” On this last point, Lemley and the DOJ apparently read the MFN clause in the agreement differently.

Einer Elhauge¹⁶ finds similar benefits from the settlement, e.g., that it “has no anticompetitive effects and dramatic pro-competitive effects, including resurrecting a treasure trove of intellectual heritage that would otherwise largely be lost and making books more easily accessible to more persons than they ever have been in history.” Elhauge’s distinctive emphasis is that the settlement reduces the costs of entry by rivals to Google in a variety of ways. Libraries that obtain digital copies of their collections from Google can resell out-of-copyright digital copies, or copyrighted works with the permission of the rights holder. The availability of digital copies for scanning will assist in the development of search algorithms that compete with Google’s. Rival distributors will have access to out-of-print books, which will be digitized and thus more easily licensed by the rightsholders. Elhauge (and Lemley) also state that by

¹³ Randal Picker, *The Google Book Search Settlement: A New Orphan-Works Monopoly?*, John M. Olin Law & Economics Working Paper NO. 462 (2nd Series), University of Chicago Law School, (July 2009), available at: <http://ssrn.com/abstract=1387582>. Picker states that he has “served as a consultant in connection with the opposition to Google’s proposed deals with DoubleClick and Yahoo,” but “that nothing there bears directly on the issues raised in this paper.”

¹⁴ DOJ and Picker note in this regard a “most favored nations” clause in the settlement that requires that if the registry or similar entity “that is using any data or resources that Google provides, or that is of the type that Google provides,” institutes agreements with other distributors, those agreements cannot “disfavor or disadvantage” Google.

¹⁵ See *supra* note 9.

¹⁶ Einer R. Elhauge, *Why the Google Books Settlement is Procompetitive*, Harvard Law and Economics Discussion Paper No. 646; Harvard Public Law Working Paper No. 09-45. (September 2, 2009), available at SSRN: <http://ssrn.com/abstract=1459028>. Elhauge credits Google for research support.

making orphan works available, the settlement will clarify which books in fact are in the public domain and help identify rights holders of others by funding the Registry efforts to locate and compensate them, reducing the risk rival digital booksellers might bear in offering works actually held.

Jerry Hausman and Gregory Sidak offer a similar commentary supporting the settlement.¹⁷ They emphasize that antitrust and regulation generally impose enormous costs in delaying the introduction of new services, such as the digital book access Google would offer following approval of the settlement. The chance of this delay exacerbates the already high risks associated with coming up with a brand new product. Their skepticism regarding competition enforcement in this context arises from the possibility, in their view, that Google's database would be declared an "essential facility" with access mandated at a regulated price, e.g., through a compulsory license.¹⁸ Although they estimate that the costs to Google of digitizing books has been in the hundreds of millions, they identify Microsoft and Yahoo as other highly capitalized firms in related markets who could duplicate Google's efforts were Google to offer an inferior product at anticompetitively high prices.

IV. OBSERVATIONS

Neither time nor space permits a detailed assessment of the antitrust points raised for and against approval of the Google Books settlement. These summaries of the settlement and the commentaries only scratch the surface of a complex, multidimensional, dynamic entity; they surely do not cover all of the insights of these observers and others on both sides of this complex question. Nevertheless, a number of observations may be worth keeping in mind as the issue works its way through the settlement court and perhaps antitrust courts to come.

A. *The ASCAP-BMI Analogy*

Collective marketing of access to a broad pool of copyrighted works is not new to the economy or to antitrust courts. Rights to broadcast copyrighted music have been marketed through the collective rights organizations—the American Society of Composers, Authors, and Publishers ("ASCAP") and Broadcast Music, Inc. ("BMI")—for decades, with an antitrust history nearly as long. These are the textbook examples of "rule of reason" approaches to what is essentially collective agreement on the prices of music broadcast rights in that, without them, obtaining clearances to play songs over the radio or other media would be prohibitive. DOJ acknowledges but dismisses analogizing to ASCAP the Registry's offering digital reproduction rights through Google Books. The Registry has not negotiated similar arrangements with distributors beyond Google, and it covers sale of books and not just access rights. The former distinction is unpersuasive if the Registry is otherwise permissible; exclusive dealing with Google likely conveys no significant market power beyond that which the Registry possesses.

¹⁷ Jerry Hausman & Gregory Sidak, *Google and the Proper Antitrust Scrutiny of Orphan Books*, 5 J. COMPETITION L. ECON. 411-38 (2009), available at SSRN: <http://ssrn.com/abstract=1462282>. They state that "Hausman has received research funding from Google; Sidak has not."

¹⁸ Hausman and Sidak, *Id.*, also address concerns some have expressed regarding potential access price discrimination by Google, noting that such pricing is likely to increase access to the digital book database overall.

The latter is more interesting, in that the justification for ASCAP and BMI had been the unpredictability of broadcasting different songs, not the sale of songs themselves. However, on this score DOJ's position may be shortsighted. Digital distribution is already forcing different business models for audio sales, newspapers, television, and films. Devices such as Amazon's Kindle and the iPhone suggest that booksellers will soon be under the same pressure. In all of these settings, it may well be the case that collective sales arrangements, where users pay up-front fees with broad access rights to options without regard to publisher, record company, or broadcaster, may well become the norm. DOJ's strong stance will make it more difficult to establish ASCAP-like arrangements for these other media.

B. DOJ and Discounting: Leegin Denial?

An issue not covered in much detail in the commentary is DOJ's objection to restrictions on Google's ability to institute discounts without permission of the rightsholder. Apart from the issue of whether upstream firms should be permitted to restrict discounting—to be clear, I generally support such permission¹⁹—is DOJ's legal stance. It analyzes the settlement's discounting terms as if the *Leegin* decision, overturning the *per se* illegality of resale price maintenance ("RPM"),²⁰ had never happened. Instead, DOJ treats the Registry's restrictions on Google's discounting as horizontal price fixing, rather than a restriction the Registry imposes on its retailer, Google. Since on its face the restraint is on Google, however, one may wonder if DOJ's legal stance is a harbinger of how it plans to address discounting restrictions—by ignoring the now more permissive case law regarding RPM.

C. MFN and Reasonable Exclusivity

A third issue is the conclusion that most favored nation clauses are anticompetitive because they inhibit competition and entry. There is a sound theoretical argument behind this concern, as a commitment to match a competitor's price discourages that competitor from cutting price itself.²¹ As observed above, some supporters of the settlement point out numerous reasons why it may reduce costs of entry and promote competition. This factual dispute will not be settled here. One would expect that as a return on the effort that Google provides, that some exclusivity or at least equal treatment (that may ensure exclusivity) might be justified. However, the provisions granting Google MFN status are conditioned not just on "using any data or resources that Google provides," but also "or that is of the type that Google provides."²² Conditioning exclusivity on data provided by others may well cross a legality line.

¹⁹ Timothy Brennan, *RPM as Exclusion: RPM as Exclusion: Did the U.S. Supreme Court Stumble Upon the Missing Theory of Harm?*, 53 ANTITRUST BULLETIN 967-86 (2008). For a superb recent explication of the case for allowing upstream firms to control downstream pricing, see Ralph Winter, *Resale Price Maintenance with and without Free Riding*, presentation at the Federal Trade Commission's workshop, *Resale Price Maintenance Under the Sherman Act and the Federal Trade Commission Act*, Feb. 20, 2009, available at <http://www.ftc.gov/opp/workshops/rpm/docs/rwinter0217.pdf>.

²⁰ *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

²¹ Steven Salop, *Practices That (Credibly) Facilitate Oligopoly Coordination*, in *NEW DEVELOPMENTS IN THE ANALYSIS OF MARKET STRUCTURE* STIGLITZ, 265-290, (Joseph and Frank Mathewson, ed., 1986)

²² Settlement Agreement, 3.8 (a).

D. Delineating a Relevant Book Market.

The various claims of price fixing both within the class of copyright holders and between them and orphan works implicitly suggest some relevant market in books. Delineating such a market is easier said than done, in part because the copyright laws exist to maintain significant differentiation among of books. That said, one can think of examples of books that closely compete. I tell my students that few products are less differentiated than introductory microeconomics textbooks. One might also imagine oneself at an airport shop deciding on the basis of price whether to get the latest mystery from Sara Paretsky or Sue Grafton. But by and large, the notion that the Google agreement suppresses competition among books, or enables booksellers to raise price by setting terms for orphan books (that otherwise might not even be practically available) sounds good but remains an assertion badly in need of empirical support.²³

E. Book Markets and Foreclosure: A Necessary Condition

The book delineation question is crucial not merely for assessing the scale of competitive harms from alleged price fixing. For an arrangement to foreclose entry by rivals, it has to make it more expensive for rivals to operate. This, in turn, requires monopolization of a relevant market in a complement to the service the alleged monopolist offers—a broader issue given the increased scrutiny U.S. agencies are planning to give single-firm conduct.²⁴ For exclusivity cases, delineation of the relevant complement market is crucial in identifying if a practice substantially lessens competition.

In the case of Google's alleged foreclosure, that complement is the set of books; the question is whether Google is able to raise the prices other rivals would have to pay rightsholders to obtain distribution over the books above what those rightsholders would be able to charge on their own. This requires exclusivity, whether contracting with Google make it more expensive for that right holder to contract with another. It also requires breadth, whether Google's arrangement spans enough of the universe of books to force rivals to accept less desirable offerings. As outlined above, analysts differ on the exclusivity afforded Google by the settlement agreement, but even if it does give some exclusivity, one still has to establish that Google's arrangements suppressed meaningful competition among the books covered.²⁵

²³ I have not worked on mergers in the book industry, but one can imagine objecting to a merger between major publishing houses not on the basis of their current catalogs, but on limiting price and quality competition in the services they would provide authors of future books.

²⁴ GCP readers can find a discussion of complement market monopolization in Timothy Brennan, *The Complement Market/Final Consumer Distinction: Exclusion & Predation in the U.S. Department of Justice Section 2 Report*, GLOBAL COMPETITION POL'Y (Oct. 2008, Release One): 1-12, available at <http://www.globalcompetitionpolicy.org/index.php?id=1408&action=907>.

²⁵ Rivals could be hurt even if books do not directly compete, if entry into the digital distribution market requires access to simply a large or diverse collection of books and Google's arrangement leaves too small an amount left over. See Eric. J. Rasmusen, Mark Ramseyer & John Wiley, NAKED EXCLUSION, 81 AMER. ECON. REV. 1137-1145, (1991).

V. ORPHAN WORKS

The above aspects make the Google Books settlement process something to watch not just for those interested in books, digital searches, and information markets, but for the competition policy community as a whole. In addition, one other aspect of the settlement raises broader questions of property law. The central concern of the commentaries is the settlement's provisions regarding orphan works. One can fairly wonder how a settlement can cover a class whose members by definition cannot be identified. Leaving that aside, the case overall presents a puzzle about how one should treat property that is probably owned but where the owner cannot be found. The default view on this is not clear; one can think of this as equivalent to estray, e.g., defining obligations to find the owner of a lost wallet before the finder can legally keep the money.

The record in the Google Books case establishes that this is a significant issue. Even Hausman and Sidak, who are skeptical of arguments based on suppression of competition from orphan books, estimate that 9 percent of the books Google has copied are orphan books.²⁶ One wonders if some doctrine in copyright akin to adverse possession in property law should apply. A copyrighted work could enter the public domain after it has been openly distributed for some amount of time. The distributor's liability could be limited if it has undertaken due effort to find the copyright holder.²⁷ Even if such a legal regime is a good idea, a separate issue is whether it should be the result of common law evolution, statutory intervention, or, as in this case, a settlement between Google and holders of non-orphaned books.

²⁶ Hausman and Sidak, *supra* note 16 at 420.

²⁷ Googling might be a minimum requirement.