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"Siri: What is Antitrust?"

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I. THINK SHERMAN ACT

The DOJ's antitrust lawsuit against Apple and various book publishers, alleging an unlawful conspiracy to raise eBook prices,[2] evoked a swift and visceral reaction online. Mac-o-philes the world over did a double take at their tablet screens and began posting furiously about the DOJ specifically and antitrust in general

Two things became apparent.

One, most people have no idea what antitrust actually does. And the fault rests squarely on us, as antitrust practitioners. Antitrust is a terrible word. It starts with a negative prefix. Nearly half of it is spent preparing the listener for what it is not.[3] Talk about it for too long, and people's eyes begin to glaze over, and excuses are made about refreshing one's drink or the lateness of the hour.[4]

Two, the people who like Apple really, really like Apple. While that's easy to mock, it's an incredible story to think about. By the late '90s, under the dial-a-Dell model, computers had become a commodity business. Apple went in the other direction, investing in style and making computers a premium product. Apple became expensive and chic, like Bang & Olufsen if Bang & Olufsen had targeted a demographics two generations younger.

Nor was Steve Jobs content with turning a handsome profit merely on the sale of computers; it was his vision to use his stylish showpiece consumer products to upend a variety of staid industries (which would, in turn, increase sales of said stylish showpiece consumer products). While it may be easy to dismiss some of the Mac-o-Philes' criticisms with the always-infuriating "oh, they just don't *understand* antitrust," they are entirely right about one thing: The model Apple sought to apply in the eBook industry is the same iTunes model it has applied elsewhere without challenge under the antitrust laws.

II. THE ANTITRUST ARGUMENT IN A NUTSHELL

The DOJ alleges that Apple served as the "hub" in a "hub-and-spoke" conspiracy to raise eBook prices and restrain competition. Until Apple came along, the eBook industry[5] had been

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[1] Anant Raut is an antitrust attorney in Washington, D.C. All of the views expressed herein are his, and his alone.

[2] *United States of America v. Apple, Inc., et al.*, 1:12-CV-02826-UA (S.D.N.Y. April 11, 2012) (hereinafter "Complaint."

[3] And has anyone even used the term "trust" in that sense since the Dodgers left Brooklyn?

[4] Nor does insisting upon the term "antitrust," while the rest of the world uses the more intuitive term "competition" help. But hey, maybe "soccer" will catch on eventually too.

[5] I use the term "industry," rather than "market," because whether it's a separate product market, in the antitrust sense, is debatable. Many of the arguments made by the DOJ in paragraph 99 of the complaint in support of an eBook product market actually go towards establishing an *eReader* product market.

dominated by Amazon, with its dedicated Kindle eBook reading devices. Amazon operated what is known as the wholesale model, in which the publishing houses supplied their eBooks at a wholesale price to Amazon, which Amazon then resold at a price of its choosing. Amazon bargained hard with publishers to provide their eBooks at low wholesale prices, which then allowed Amazon to sell eBooks at the relatively low price of $9.99.

Apple, according to DOJ's complaint, proposed an alternative model, an "agency" model, in which Apple would sell eBooks at fixed tiers and take a fixed percentage of the sale price (30 percent). The DOJ alleges that the business model could only have worked if every publisher agreed to sell through Apple's agency model and either not sell to Amazon or collectively agreed to boycott Amazon until it sold their books at a price comparable to Apple's.[6]

There is established precedent for the DOJ's legal argument. Hub-and-spoke models were found to violate the antitrust laws in *Interstate Circuit.*[7] In that case, the Supreme Court affirmed that a group of movie distributors (accounting for 75 percent of all first-class feature films exhibited in the United States) and a group of movie exhibitors (accounting for approximately 74 percent of all fees from licenses to show movies in theaters in their respective parts of Texas) conspired to fix prices and restrain competition from independent movie theater operators. The agreement was a letter sent by the exhibitors to each distributor, *cc'ing each of the other distributors*, proposing both new, slightly higher retail prices for the films under their control as well as restrictions on licensing to second-run theaters and theaters promoting double features.

Even though the exhibitors and distributors argued that the letters were individual vertical agreements, the Supreme Court held that the fact that all of the other distributors had been copied made it clear that no distributor would be going it alone. Thus, this raising of prices was an action that would not have been in their individual self-interests, and was a radical departure from a previous practice that was made possible only through collusion.

In *Toys 'R Us,*[8] toy retailer Toys 'R Us was charged with facilitating a conspiracy among toy manufacturers to limit supply to rival toy warehouse retailers. Toys 'R Us was the dominant toy retailer at the time, but wanted to nip competition in the bud, so it entered into a series of agreements with its suppliers in which it would only sell products from those manufacturers that were not available in other retail outlets. In deciding in favor of the FTC, the court held that limiting sales to Toys 'R Us' rivals was contrary to every individual manufacturer's business, and that the agreements had been made contingent upon the manufacturers' competitors agreeing to the same terms.

Note a couple of critical differences between these cases and the eBooks case. In *Toys 'R Us* and *Interstate Circuit*, the "hub" in the hub-and-spoke conspiracies had considerable market power; in eBooks, it is Amazon, not Apple, that is the dominant player. Moreover, in both *Toys 'R Us* and *Interstate Circuit*, the illegal agreements that facilitated the conspiracies were new business arrangements created specifically to suppress competition, whereas in eBooks, Apple

[6] The complaint also contains an almost fetishistic level of detail as to which restaurants (and in which rooms) meetings of conspirators are alleged to have taken place, creating an erstwhile Zagat's Guide to Violating Section 1 of the Sherman Act.

[7] *Interstate Circuit, Inc. v. United States*, 306 US 208 (1939).

[8] *Toys 'R Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000).

was applying a model it had been using for 8+ years, a model that had already upended not one, but two industries.

III. I'VE HEARD THIS ONE BEFORE

Recall the music industry's early fumblings with a business model for selling downloadable digital music. It may seem quaint in retrospect, but there was a time around 1999 when Napster was seen as the music business' apocalypse. At its peak, millions of digital copies of songs were flying back and forth across Napster's peer-to-peer network without the record companies receiving a single cent.

The record companies reacted by creating new business models that treated their customers as career criminals, replacing the traditional dynamic of merchant-customer with that of prison guard-inmate. The business models were hideously conceived, cumbersome to use, and laughably executed.

For example, PressPlay was a joint venture among Universal, Sony, and EMI. For $15 per month, users could listen to 500 low-quality audio streams, download 50 audio tracks, and burn 10 tracks to a CD. Users that were huge fans of particular artists were out of luck, because they couldn't burn more than two tracks from the same artist, nor were all of the participating record companies' artists even part of the service. In another example, MusicNet was a competing joint venture among Warner Music, BMG, and EMI. For $10 per month, users were entitled to 100 streamed songs and 100 "downloads," in quotes because the "downloads" expired after 30 days. And if users "downloaded" them again, they counted as a new "download."[9] The listening public took off their headphones, carefully reviewed these fine options, and went back to swapping music online for free.[10]

And that's where digital music stood—in a tense showdown between the music public and the music publishers, with the kind of mutual animus typically found between flight attendants and coach class.

Apple (at the time, lightly regarded as a computer company that was coming out of a nosedive because of the design instincts of Steve Jobs 2.0) was about to disrupt the music industry at two levels—first, by breaking free of years of incrementalism and radically redesigning the portable music player for a purely digital age (the iPod), and second, by single-handedly forcing the record companies to change their business models to make purchasing music for these devices as simple and intuitive as the devices themselves (iTunes).

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[9] Dan Tynan, *The 25 Worst Tech Products of All Time*, PC WORLD, (May 26, 2006), *available at* http://www.pcworld.com/article/125772-3/the_25_worst_tech_products_of_all_time.html, and Tom Spring, *Digital Music: Worth Buying Yet?,* PC WORLD (Jan. 18, 2002), *available at* http://www.pcworld.com/article/80564/digital_music_worth_buying_yet.html.

[10] The 5-Blade Razor Award for costliest example of most useless innovation goes to Sony, which spent $$$ developing an impregnable digital locking mechanism for its CDs. Basically, it encoded propriety software onto the clear outer rim of the CD that essentially messed with the computer in order to prevent file-sharing. Within a few days of its highly-touted release, the listening public took off their headphones and discovered that if you blacked out the outermost edge with a Sharpie, you completely disabled the locking mechanism, and started swapping all of this newly acquired music online for free.

The key elements of the iTunes business model were uniform pricing, lack of digital rights management restrictions, and ease of use. Consumers used to paying nothing for music quite willingly began paying something, generating new revenue for both Apple and the music publishers, and increasing overall consumption of music.

Eventually, the record companies would begin pushing back against the uniformity in pricing, and demand variable pricing ability, a protracted multi-year battle that Apple ultimately grudgingly conceded.[11] But, by that point, Apple had become enamored with its model, and had begun taking it to other industries.

IV. BREAKING NEWS

Stop the presses: the online news model has been a disaster. For some reason, during the gorgeous efflorescence of the Web, print journalism companies thought that it was very important to give away all of their proprietary content for free rather than risk having people read something else on the Internet.[12] It's sort of like the Napster story had the record companies gone to Shawn Fanning's house[13] and dropped off all of their master recordings and a year's supply of Hot Pockets. Predictably, newspapers that gave away their content discovered that they were not making enough money to cover costs, and resorted to slashing personnel, coverage, or incurring massive amounts of debt financing, resulting in truly sad stories about the *Los Angeles Times* running fake news articles to promote movies and TV shows, and shock jocks installed as management harassing the *Chicago Tribune's* female reporters.

How bad was it? The *New York Times* published a piece by columnist David Carr in which he essentially begged for someone to help them collude to raise prices:

> …by coming up with an easy user interface and obtaining the cooperation of a broad swath of music companies, Mr. Jobs helped pull the [music] business off the brink. He has been accused of running roughshod over the music labels, which are a fraction of their former size. But they are still in business. Those of us who are in the newspaper business could not be blamed for hoping that someone like him comes along and ruins our business as well by pulling the same trick: convincing the millions of interested readers who get their news every day free on newspaper sites that it's time to pay up.[14]

According to the *San Jose Mercury N*ews, Jobs took the iTunes agency model and offered it to newspapers in 2010, in advance of the introduction of yet another stylish and revolutionary product, the iPad. News media at the time indicated that Jobs was proposing the same terms that he had proposed to the music industry—a 30 percent cut of all subscriptions sold through the App Store. Initially, publishers balked at forking over so much of their revenue without the

[11] Although Apple may have the last laugh. It turns out that Steve Jobs may have been on to something with the simplicity of a uniform pricing model. In a 2010 investor call, Warner Music Group CEO Edgar Bronfman admitted that growth in the sales of digital music had slowed, in part due to the fact that consumers were now rattled by variable pricing that been introduced into the iTunes store.

[12] To this day, this is an incredibly popular internet business model. If you can say it with a straight face, and liberally sprinkle in the terms "social" and "targeted advertisement," rich strangers will just hand you money.

[13] Shawn Fanning is the developer of Napster.

[14] David Carr, NEW YORK TIMES, (Jan. 12, 2009), *available at* http://www.nytimes.com/2009/01/12/business/media/12carr.html

ability to control prices. But once Apple's Newsstand application was introduced in October 2011, it became a huge success straight out of the gate.

Though Newsstand has only been live for a few months, participating companies are boasting of record sales. Conde Nast has reported a 268 percent increase in the sale of its digital magazines,[15] while another study estimates that sales of the top 100 publications in Newsstand is generating approximately $70,000 per day.[16]

More choices for consumers, more sales for content providers, more sales of Apple products—that has been the legacy of the iTunes agency model. So what was so illegal about introducing it into the eBook market?

V. HOLES AT THE CORE OF THE CASE AGAINST APPLE

A. The Flaw in the Price-Fixing Argument

"What Do You Mean, 'We'?"

In the eBooks complaint, the DOJ alleges two violations of the antitrust laws—an unlawful conspiracy to fix prices and an unreasonable restraint on trade. The complaint treats Apple as the hub in a hub-and-spoke conspiracy that encompasses both, yet it's not clear that Apple belongs in either since hub-and-spoke models require a single-mindedness of purpose by all of the alleged perpetrators.[17]

Even accepting the DOJ's allegations that the publishers' sole focus was to raise the price of eBooks, it's not clear that Apple shared the same goals. The DOJ must argue that Apple's purpose in introducing the iTunes agency model into the eBook industry was to fix prices with the publishers. But, as shown above, Apple was introducing the exact same business model that it had been successfully using elsewhere. In *Toys 'R Us* and *Interstate Circuit*, the agreements at issue were the first of their kind; in eBooks, Apple's agency model was the exact same one it had been using for 8 years.

The DOJ argues that "[t]o accomplish the goal of raising eBook prices and otherwise limiting retail competition for eBooks, Apple and the Publisher Defendants jointly agreed to alter the business model governing the relationship between publishers and retailers" and that "[t]his change in business model would not have occurred without the conspiracy among the

[15] David Kaplan, *Publishers See Apple Newsstand Sales Surge, But Ad Sales Slow to Follow*, paidContent.org. (Oct. 26, 2011), *available at* http://paidcontent.org/2011/10/26/419-publishers-see-apple-newsstand-sales-surge-as-ad-sales-slow-to-follow/.

[16] Tom Cheredar, *Apple's Newsstand Generates $70K Per Day, Study Says*, venturebeat.com (March 27, 2012), *available at* http://venturebeat.com/2012/03/27/apple-newsstand-daily-revenue/.

[17] *See Impro Products, Inc. v. Herrick*, 715 F.2d 1267, 1273 (8th Cir. Iowa 1983) ("Moreover, to satisfy the concerted action requirement, the plaintiff must demonstrate that the defendants shared a 'unity of purpose or a common design and understanding, or a meeting of the minds' to engage in the conduct prohibited by the Sherman Act."), and *American Tobacco Co. v. United States*, 328 U.S. 781, 810 (U.S. 1946) ("Where…the conspirators had a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement, the conclusion that a conspiracy is established is justified.")

Defendants."[18] But there was no "change in business model" on Apple's end. Without that, it's not clear that Apple can be accused of participating in a hub-and-spoke conspiracy.

B. The Flaw in the Boycott Argument

"With Rims Like These, Who Needs a Hub?"

The DOJ further argues that the defendants created an unreasonable restraint on trade, in the form of a boycott of Amazon and eliminating competition among eBook retailers. With respect to the boycott argument, the DOJ has made such a compelling case in establishing the "rim" of its hub-and-spoke conspiracy that it may have undercut its argument against Apple.

In terms of the boycott, where the publishers rallied behind Macmillan and threatened to withhold their eBooks unless Amazon agreed to adopt a model comparable to Apple's, the only way for the DOJ to bring Apple in as a defendant is through a hub-and-spoke model. But Apple has nothing with which to boycott—it has never been a content supplier to Amazon, it doesn't publish eBooks, and it doesn't own the rights to eBooks. The only legal argument is that Apple somehow facilitated the boycott through the agency model.

Except that's not what the DOJ argues. In order to prove a hub-and-spoke conspiracy, one must establish evidence of the "rim," i.e., horizontal agreements among the spokes. In this case, the publishers are the spokes and the DOJ must demonstrate that they colluded with each other to raise the prices of eBooks. Without this argument, one is left with a series of perfectly legal vertical agreements between the hub and each of the publishers.

The DOJ supports its allegations of a rim, perhaps too well, because it is unclear what role Apple (the hub) played in the boycott of Amazon. "After executing the Apple Agency Agreement, the Publisher Defendants all then quickly acted to complete the scheme by imposing agency agreements on all their other retailers….Once in control of retail prices, the Publisher Defendants limited retail price competition among themselves."[19] The DOJ makes strong allegations supporting a conspiracy among the publishers. But Apple isn't even mentioned, nor is it clear that it's ever involved at all. "…[B]y refusing to compete with one another for Amazon's business, the Publisher Defendants could force Amazon to accept the Publisher defendant's new contract terms and to change its pricing strategies….The Publisher Defendants thus conspired to act collectively…"[20]

It's unclear why the publishers would need to pass information through Apple when they seem comfortable calling each other directly:

> The executive in charge of Apple's inchoate eBooks business, Eddy Cue, telephoned each Publisher Defendant and Random House on or around December 8, 2009 to schedule exploratory meetings in New York City on December 15 and December 16….It appears that Hachette and HarperCollins communicated with each other about moving to an agency model during the brief

[18] Complaint, ¶5.
[19] Complaint, ¶8:
[20] Complaint, ¶¶46-47:

> window between Mr. Cue's first telephone calls to the Publisher Defendants and his visit to meet with their CEOs.[21]

The DOJ also seems to suggest that the publishers would have moved to an agency model even without Apple. "In negotiating the retail price MFN with Apple, 'some of [the Publisher Defendants]' asserted that Apple did not need the provision 'because they would be moving to an agency model with [the other eBook retailers,] regardless.'"[22]

In other words, the DOJ's boycotting case against the publishers exists without the presence of Apple. "Near the time Apple first presented the agency model, one Publisher Defendant's CEO used a telephone call…to tell Penguin USA CEO David Shanks that 'everyone is in the same place with Apple.'"[23]

C. Flaws in the Elimination of Competition Among eBook Retailers Argument

"We Just Got Here, Actually"

Elimination of competition among eBook retailers as an unlawful restraint of trade will most likely be evaluated under *rule of reason* analysis (in which the pro-competitive benefits of a disputed practice are weighed against its anticompetitive effects). The argument will turn upon the legality of Apple's agency model, and the standard for review is whether the behavior at issue appears to be one that would always or almost always restrict competition and decrease output, or is designed to increase efficiency and promote competition.[24]

The agency model as a standalone business idea is pro-competitive enough to warrant *rule of reason*, rather than *per se*, review. Recall the market immediately after the publishers signed the Apple Agency Agreements. Consumers were being offered eBooks at different prices for an increased number of platforms. Consumers could opt for certain quality benefits in reading eBooks that were optimized for Apple products and sold through iTunes. Consumers would finally be able to read eBooks in color, something that Amazon only begrudgingly adopted after Apple made it mainstream. So, at the moment the agreements were signed, consumers had more choice, and Apple had become a viable competitor to Amazon, both powerful pro-competitive benefits. And any anticompetitive effects were lessened because of Apple's lack of market share.

Rule of reason analysis factors the impact the alleged perpetrator's actions have on the market by virtue of its market share. Apple had zero share of the eBook retailing industry when the conspiracy was alleged to have taken place, and its chances of success were hazy at best. Apple was debuting a brand-new platform, the likes of which the world had never seen, and was challenging head-on an entrenched market dominant retailer, one whose name had become synonymous with bookselling. The history of technology is paved with crushed expectations. Even when the publishers signed on, there was no guarantee that Apple's eBook endeavor would be a success, or that consumers would abandon their Kindles and Amazon in favor of Apple's iPad. The anticompetitive harm was minimal.

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[21] Complaint, ¶¶53-54.
[22] Complaint, ¶67.
[23] Complaint, ¶73:
[24] *Broadcast Music v. CBS*, 441 U.S. 1, 19-20 (1979).

Last, if Apple were truly trying to eliminate the threat of competition from Amazon, why continue to allow the Kindle app to be downloaded onto Apple products when Amazon didn't offer reciprocity?

VI. CONCLUSION

Much of the debate within the antitrust community has been whether there's a greater harm in allowing Amazon to remain a monopolist in eBooks, but it misses a point glossed over within the complaint—there was a point where the two models could have coexisted. Even after Apple introduced its agency model, Amazon insisted upon its $9.99 standard. It was only when the other publishers allegedly conspired with Macmillan to boycott Amazon that Amazon was forced to raise its prices.

The DOJ could have easily confined its case to the conspiratorial actions among publishers. In going after Apple, it may have bitten off more than it can chew.