No. 15-565

In the Supreme Court of the United States

APPLE INC.,

Petitioner,

v.

UNITED STATES OF AMERICA, ET AL.

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF ECONOMISTS AS AMICI CURIAE IN SUPPORT OF PETITIONER

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INTEREST OF AMICI CURIAE[1]

Amici, who are listed in the Appendix hereto, are professors and scholars who teach and write on economics, specializing principally in the economics of industrial organization, competition, and antitrust policy. They include members of the faculties of some of the nation's leading academic institutions and economists who have served as Deputy Assistant Attorney General for Economic Analysis in the U.S. Department of Justice, Antitrust Division. *Amici* submit this brief to share with the Court their expertise in the economics of industrial organization, competition, and antitrust policy as it bears on the question presented.

INTRODUCTION AND SUMMARY OF ARGUMENT

The issue in this case is whether it was anticompetitive for a new entrant into the distribution of e-books to propose and gather e-book publishers to accept an alternative vertical contracting structure—an "agency" model that, by transferring the pricing of e-books from retailers to publishers, likely would have led to short-term increases in some e-books prices. *Amici* believe that is an unusually complex antitrust question, in part because Apple proposed not just a particular *term* in a vertical agreement, but an entirely different vertical *structure*, and in part because delegating pricing authority to publishers may benefit

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[1] No counsel for any party authored this brief in whole or in part. No person or entity, other than amicus and its members, made a monetary contribution intended to fund the preparation or submission of this brief. Petitioner and respondents consented to the filing of this brief after receiving timely notice.

consumers even if it results in short term price increases. There is no general answer to whether an agency model leads to higher equilibrium pricing or in a broader sense is beneficial or harmful to competition. *Amici* believe that agency structures are most often not anticompetitive, but sometimes may be. And here the economic issues are particularly complex because of Amazon's pricing of e-books below their acquisition costs and the publishers' well-known frustration with that. Apple would have rationally advanced proposals to address the publishers' concerns in order to induce publishers to participate on its platform.

The courts below did not grapple with any of this complexity. They accepted the government's argument that one should apply antitrust law's *per se* rule to Apple's proposals and agreements with e-books publishers. *Amici* submit this was error. At the least, all should be able to agree that Apple's contracting with the publishers does not fit in the category of business conduct that economic analysis or judicial experience suggests is invariably or clearly anticompetitive. *See State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997). The rule of reason is the proper analytical framework for addressing this case.

First, the rule of reason applies because the structure and impact of the principal Apple conduct at issue—proposing and securing agency agreements with e-book publishers—are plainly vertical. Since *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), this Court's decisions have consistently applied the rule of reason to vertical arrangements in recognition that such arrangements typically have efficiency justifications and context-dependent competitive effects. *See id.* at 51, 57-59 (territorial

restrictions); *Kahn*, 522 U.S. at 11, 14-17 (agreements setting maximum resale prices); *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 892-93 (2007) (agreements setting minimum resale prices).

The government and the courts below contended that the *per se* rule should apply because the *intent* and horizontal *effects* of the agency model justified a conclusion that Apple "orchestrated" anticompetitive horizontal collusion among publishers. *Amici* find this logic unhelpful and inconsistent with this Court's teaching that "[l]egal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law." *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 466-67 (1992). The most important market reality in this case is that Apple, which complements rather than competes with publishers, proposed *an entirely different vertical contracting structure* than the prevailing wholesale model used by the dominant incumbent, Amazon. Apple proposed no less than to reorganize the vertical relationships between e-books publishers and retailers, transferring the pricing function to the content owners. And it did so from the perspective of a new entrant who knew from public information that the publishers were dissatisfied with an unintended consequence of the wholesale model, which had allowed Amazon to use e-books as loss leaders for a broader e-reader and e-commerce business.

The new vertical structure Apple proposed—the agency model—cannot be dismissed as some artifice for publisher-level collusion. It is widely used, particularly in e-commerce where it is employed by both Apple and Google for distributing mobile phone apps, by ticket

resellers such as StubHub, by eBay, and even by Amazon in connection with its Amazon Marketplace. The salient feature of the model is that the downstream platforms delegate retail pricing decisions to the upstream content or merchandise providers. Economic analysis suggests that such delegation has price effects because suppliers have different economic incentives than retailers. But this implies that "moving to the agency model shifts the retail competition in the market from being inter-retailer to inter-supplier." Justin P. Johnson, *The Agency and Wholesale Models in Electronic Content Markets* (Mar. 15, 2013), http://ssrn.com/abstract=2126808. That is not *necessarily* harmful to consumers, and could in fact be procompetitive. *Id.* It is also economically incorrect to treat a proposal to delegate pricing to the content owners as price-*fixing*, and thus *per se* illegal. The higher retail e-books prices that publishers might set under the agency model are neither literally nor in substance fixed prices.

Thus, from the economic perspective, determining whether Apple's conduct in proposing and advocating for the agency model was anticompetitive requires an assessment of actual market effects in the particular circumstances of Apple's entry. One might argue that proposing the new model was the most competitive move Apple could make under the circumstances, maximizing the likelihood of a successful entry and increasing industry output. One could argue (as Judge Jacobs argued in dissent) that it was the only feasible move Apple could make. And yet, one might also make the government's argument that the purpose and effect of Apple's conduct was to facilitate upstream collusion, leading to higher prices and lower output.

Amici do not dismiss any of these arguments, but submit they are the stuff of the rule of reason, the analytical construct that entails consideration of "all of the circumstances of a case." *Leegin*, 551 U.S. at 885 (quoting *Continental T.V.*, 433 U.S. at 49). So shortcutting the full rule of reason analysis was error, undoubtedly omitting from consideration much of the pertinent economic analysis.

Amici are particularly concerned by how the Court of Appeals got to this unlikely conclusion. The decision seems to rest on two points: first, that Apple knew the publishers wanted to raise e-books prices and proselytized the agency model as a way to accomplish that, and second, that there were adverse horizontal effects. Neither point justifies *per se* condemnation.

Amici accept that Apple understood and tried to capitalize on the publishers' frustration with Amazon's decision to use e-books as loss leaders. From a competitive perspective, Apple *should* try to capitalize on that frustration by offering publishers a distribution alternative that is more consistent with their business objectives. The issues in this case cannot be approached as if Amazon's pricing was sacrosanct simply because it entailed "low" prices. The agency structure Apple proposed was a rational proposal under the competitive circumstances Apple faced. Moreover, there is nothing inherently anticompetitive about Apple talking openly with the publishers about how moving to the agency model could solve their issues with Amazon. In *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 763-64 (1984), the Court properly observed that "[i]n order to assure an efficient distribution system, manufacturers and distributors constantly must coordinate their activities," and thus it

"would create an irrational dislocation in the market" to punish discussions of competitively sensitive issues. Apple's efforts to sell the agency model by telling the publishers it would address a well-understood complaint they had with Amazon's e-books pricing strategy is not inherently anticompetitive behavior that antitrust law should condemn under the *per se* rule.

As for the potential of the agency model to facilitate publisher-level collusion, that is itself a complex question. The immediate effect of the model is to put the decision-making power concerning retail prices in the hands of the publishers, in this case subject to a price cap. What the publishers do with that power depends on the dynamics of inter-publisher competition, the transfer terms with the distributors (e.g., the commission rate), and other market-specific factors. Facilitating collusion on higher prices is just one possibility, not any greater than posed by resale price maintenance, in which the retailer also charges prices set by its supplier. And therefore it is difficult to understand why *Leegin* and *Khan* did not control, as both cases recognized the potential for vertical price restraints to facilitate horizontal collusion—and yet required rule of reason analysis. *Leegin*, 551 U.S. at 892-93; *Khan*, 522 U.S. at 17-18. Furthermore, in modern antitrust analysis, vertical restraints are condemned principally because of horizontal effects—or not at all. *See* Jonathan B. Baker, *Vertical Restraints With Horizontal Consequences: Competitive Effects of "Most-Favored-Customer" Clauses*, 64 Antitrust L.J. 517 (1996). Since "all anticompetitive effects are by definition horizontal effects," *Business Elecs. Corp. v. Sharp Elecs. Corp.*,

485 U.S. 717, 730 n.4 (1988), one should *always* be able to advance a horizontal effects argument about a problematic vertical restraint. If that becomes the basis for applying the *per se* rule instead of the rule of reason, then the work this Court has done since *GTE Sylvania* to rationalize the law of vertical restraints could be severely undermined.

RELEVANT FACTS FROM THE PERSPECTIVE OF ANTITRUST ECONOMICS

The four judicial opinions that this case has generated evidence a significant disagreement as to what the case is about. For the District Court, it was about "how and why the prices for many electronic books, or 'e-books,' rose significantly in the United States in April 2010"—a strikingly narrow perspective that appears in the first sentence of the court's Opinion and predetermined its conclusions. App. 121a.[2] For the Second Circuit majority, it was about Apple "orchestrat[ing]" a horizontal conspiracy among the publishers. App. 55a. For Judge Jacobs, it was about steps Apple took "to compete with a monopolist and open the market to more entrants." App. 110a-17a (Jacobs, J., dissenting).

Amici submit that the question at hand—whether the *per se* rule or rule of reason applies—turns on the fundamental nature of the conduct at issue, which needs to be identified and understood, and not just on whether the conduct arguably included agreements among competitors. Some details matter to how a rule

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[2] Citations to the Court of Appeals and District Court decisions are to the Appendix to the Petition for Certiorari ("App.").

of reason analysis would turn out, but *not* to whether that is the proper analytical construct.

The e-books market as Apple found it. This is a case about new entry into an established and highly concentrated market. In 2009, Apple had developed and was getting ready to launch the iPad, which among its many other attributes allows one to read e-books. App. 140a. Apple decided it wanted to sell e-books in what would become the iBookstore. App. 142a. Apple thus assessed the market for retail e-books distribution.

That market was one in which e-books publishers sold their content to retailers under a traditional wholesale model "where a publisher receives its designated wholesale price for each e-book and the retailer sets the retail price." App. 128a. There was only one e-books retailer of strategic importance: Amazon, whose e-books market share was on the order of 90%.

Amazon's loss-leader pricing. Amazon had adopted a business strategy of selling most high-demand e-books for $9.99, which was often several dollars below the wholesale price. Amazon could rationally do this because e-books created "pull" for Amazon's vastly larger e-commerce business and facilitated Kindle sales. Apple had to deal with that loss leader pricing.

The publishers' known frustration with Amazon's pricing. When surveying the e-books market, Apple found numerous public indications that publishers were frustrated by the fact that Amazon was selling their books below cost. The fact of this frustration is undisputed. There is an entire section of the District Court decision on "Publishers' Discontent with the

$9.99 Price Point," App. 131a-32a, followed by another entitled "January 2009–December 2009: Publisher Defendants Pursue Strategies to Combat Amazon Pricing," App. 132a-40a. In the latter section, the District Court referenced *Wall Street Journal* and *New York Times* articles on publisher discontent with "the cut-rate $9.99 pricing of e-book best sellers." App. 137a-38a (quoting *Wall Street Journal*).

One might ask why the publishers would care that Amazon was willing to sell for $9.99 a book that it bought for $13.00, since the lower retail price stimulates demand. The answer is because it created a channel conflict with brick and mortar sales. "The Publisher Defendants wanted to shift their industry to higher e-book prices to protect the prices of their physical books and the brick and mortar stores that sold those physical books." App. 163a. This is a familiar dynamic in vertical restraints cases, including this Court's decisions. *See Monsanto*, 465 U.S. at 762-63 (discussing conflicts between full-price retailers and discounters).

Apple understood the publishers' frustration with Amazon's pricing and set its strategy accordingly.

Apple's familiarity with and decision to propose the agency model. As noted, digital works are commonly distributed pursuant to an agency model in which content owners set retail price. Apple has used a variant of that model in selling iPhone apps.

After initial discussions with the publishers, Apple proposed the agency model as an alternative to the prevailing wholesale model. *See* App. 156a (Apple writing to publishers: "Just like the App Store, we are proposing a principal-agency model with you, where you would be the principal and [iBookstore] would sell

your product as your agent for your account. In exchange for acting as your agent [iBookstore] would get a 30% commission for each transaction."). The District Court found that "Agency would give the Publishers the control over e-book pricing that they desired." App. 150a. That said, Apple insisted on price caps to restrain "unrealistically high prices." *Id.* Since the price caps were significantly higher than Amazon's current pricing, and the publishers disdain for that pricing was well-known, the courts below reasonably assumed that Apple understood and, within limits, would accept retail prices higher than Amazon's.

Apple also proposed an MFN clause that required each publisher to price its offerings at the iBookstore no higher than the price offered by any other e-book retailer. While MFN provisions are common, the United States and the courts below maintained that the purpose and effect of these MFNs was to force the publishers to adopt the agency model for e-books generally.

Apple's efforts to convince publishers to adopt the agency model. The government's *per se* arguments are less about the *agreements* Apple reached with publishers than the *communications* about higher retail prices that occurred as Apple proposed and urged adoption of the agency model. In particular, Apple "bluntly" told the publishers that the agency model "was 'the best chance for publishers to challenge the 9.99 price point.'" App. 161a. Apple also tried to rally the publishers to support the agency model *as a group*, believing that for its entry to succeed it needed "agreements in place with a core group of Publishers." App. 127a. Thus in a series of bilateral emails, telephone calls and meetings, Apple sold the industry

on the advantages of the agency model, and to encourage publishers to sign on, it apprised individual publishers of the progress it was making with others.

This is what the District Court and Court of Appeals majority viewed as "orchestrating" horizontal conspiracy, and is the essential step in their decisions to apply the *per se* rule. *Amici* believe that this step in the courts' analyses was both incorrect and dangerous because, even if one can characterize proposing and securing multiple vertical agreements as "orchestrating" horizontal agreement, the procompetitive potential of the vertical agreements remains, and determining whether the outcomes here were procompetitive or anticompetitive requires a rule of reason determination. Furthermore, there is no finding that Apple knew that the publishers with whom it was dealing had begun coordinating anticompetitively among themselves in January 2009—months before Apple came onto the scene. App. 131a-32a. The arguments in favor of *per se* treatment in this case constantly conflate Apple's knowledge and acceptance of the likely outcome of *its own vertical proposals* (including some higher retail prices) with knowledge of and support for naked, horizontal collusion among publishers. Those are not the same thing, for the simple reason that Apple and the publishers could all want to see changes in Amazon's pricing without anyone conspiring. And more importantly, the substance and verticality of Apple's proposals exist no matter what the publishers were discussing among themselves before or during the negotiations.

ARGUMENT

I. Proposing And Securing An Alternative Vertical Contracting Structure Should Never Be *Per Se* Illegal

Apple has briefed the core point that the rule of reason should apply because this case concerns vertical restraints. *Amici* agree that it is important for there to be a bright line understanding that restraints that are substantively vertical are *always* subject to the rule of reason, and that the *per se* rule should apply only to entirely horizontal agreements plus, at most, hybrid agreements where the vertical contribution is a sham. This would mirror the approach this Court has taken to other kinds of efficiency-producing conduct such as joint music licensing and joint ventures, which are subject to the rule of reason unless they are shams. *See Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 20 (1979) (applying the rule of reason because an ASCAP or BMI blanket license was not a "naked [restraint] of trade with no purpose except stifling of competition" (alteration in original) (citation omitted)); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593, 597-98 (1951) (applying the *per se* rule to an ostensible joint venture that was in reality a naked agreement to divide territories and fix prices). The Court's group boycott cases show a similar pattern: naked group boycotts are *per se* illegal, *see, e.g., United States v. General Motors Corp.*, 384 U.S. 127, 145-46 (1966), exclusion from efficiency-producing collaborations is assessed under the rule of reason. *See, e.g., Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 295-96 (1985); *see also MM Steel, L.P. v. JSW Steel (USA) Inc.*, No. 14-20267, 2015 U.S. App. LEXIS 20520, at *28 (5th Cir.

Nov. 25, 2015) (distinguishing naked boycotts from the resale price maintenance issues addressed in *Leegin*).

In a naked restraint, the complementary relationship between the parties is irrelevant to the agreement made.[3] For example, imagine that a manufacturer cartel enlists a common retailer to do no more than carry messages on future prices from manufacturer-to-manufacturer. A retailer's willingness to deliver messages for a cartel generates no vertical efficiencies of any kind. Thus the retailer may properly be regarded as part of the *per se* unlawful cartel.

This case is not about a "naked [restraint] of trade with no purpose except stifling of competition." *Broadcast Music*, 441 U.S. at 20 (alteration in original) (citation omitted). Instead, it concerns a sophisticated effort at business format competition. Apple saw that the prevailing wholesale model had created an unintended channel conflict because, apparently, nothing in the publishers' agreements with Amazon set minimum prices and Amazon had decided to sell e-books as loss leaders. With no business interest in selling at a loss, Apple bid an entirely different vertical model that it thought would appeal to publishers and create maximum competitive advantage over Amazon.

Economists have recently begun studying the agency model in electronic retailing, and it can in no way be dismissed as a sham or naked restraint of trade. The work builds on earlier papers studying "strategic

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[3] *See* William F. Baxter & Daniel P. Kessler, *Toward a Consistent Theory of the Welfare Analysis of Agreements*, 47 Stan. L. Rev. 615, 616-18 (1995) (arguing that the rule of reason should apply based on the parties' economic relationship as producers of complements).

delegation" to agents,[4] and results from this first generation of models indicate that agency arrangements can often benefit downstream consumers by lowering retail prices to end users, if not immediately, then in the long run.[5] Even if retail prices would be higher in some cases in both the short and long run, agency structures can still benefit downstream consumers by stimulating the upstream content providers to invest more in content quality, variety, and so on.

The particular characteristics of the affected market are important in these analyses. Johnson, for example, gives particular attention to the role of platform lock-in and the possibility that initial low e-book prices are about locking consumers in to particular hardware (such as a Kindle), setting the stage for higher prices ("harvesting") in the future. The upstream content providers do not share the incumbent platform's incentives to subsidize early consumption, and so, in the transition to the agency model, may initially raise prices. But future retail

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[4] *See, e.g.*, Timothy W. McGuire & Richard Staelin, *An Industry Equilibrium Analysis of Downstream Vertical Integration*, 2 Marketing Science 161 (1983).

[5] The most relevant papers in this literature include Johnson, *supra*; Germain Gaudin & Alexander White, *On the Antitrust Economics of the Electronics Book Industry* (Sept. 24, 2014), http://ssrn.com/abstract=2352495; Øystein Foros, Hans Jarle Kind & Greg Shaffer, *Turning the Page on Business Formats for Digital Platforms: Does Apple's Agency Model Soften Competition* (Aug. 29, 2013), http://ssrn.com/abstract=2317715; and Vibhanshu Abhishek, Kinshuck Jerath & Z. John Zhang, *Agency Selling or Reselling? Channel Structures in Electronic Retailing* (Jan. 2015), http://ssrn.com/abstract=2013720.

prices would be expected to decline relative to the wholesale model, because publishers have no incentive or ability to "harvest." Johnson concludes that "it is shortsighted to conclude that consumers are harmed [by a move to an agency model]. Indeed … consumers are better off …." Johnson, *supra*, at 1.[6]

The consumer welfare effects of an agency model depend on trade-offs between *inter-product* and *inter-platform* competition. When the downstream firms control the retail prices, one type of competitive pressure (substitution between platforms) dominates. When control over the retail prices resides in the hands of the upstream firms, another type of competitive pressure (substitution between goods) dominates. Delegating pricing control to the level at which the competitive pressures are greater would be expected, in the absence of other salient factors, to result in lower retail prices. Foros, Kind, and Shaffer thus suggest that delegating e-book pricing to the more structurally competitive publisher level may benefit consumers in the long run. But generalization is difficult because of market specifics. In the sale of e-books, e-book publishers would be influenced by the effect that a given e-book's price has on their effort to sell printed

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[6] Gaudin and White also suggest that a platform's incentive to set low prices on e-books is greater because of lock-in considerations (to, e.g., a Kindle device). When that advantage is lost because Apple's iPad provides a widely distributed alternative, Amazon's incentive to keep retail e-books prices low is diminished, and it may raise prices even if it remains under the wholesale model. Gaudin & White, *supra*, at 4-5.

books.[7] Prices might also be affected by whether distributors sell both e-books and e-book readers.

The important point is that both the wholesale and agency models can lead to low consumer prices. So there is no basis to presume that Apple's decision to advocate for the agency model, and the publishers' willingness to adopt that model, necessarily harmed consumers. That is what a full rule of reason analysis needs to determine. Nor is this different from any other vertical case. From the economic perspective, the trade-off between *inter-product* and *inter-platform* competition is not materially different than the trade-off between *intra-brand* and *inter-brand* competition that pervades this Court's vertical restraints cases. Agency structures therefore should be subject to the same rule of reason analysis.

Apple's MFN provisions add further complexity to this case. *Amici* do not dismiss the government's contention that Apple's MFN "forced" the publishers to adopt the agency model at other e-book retailers. But neither the MFN itself nor the "forcing" narrative justifies *per se* condemnation. The considerable work economists have done studying the competitive effects of MFNs fully supports the rule of reason treatment that courts apply to such cases. *See* Jonathan B. Baker & Judith A. Chevalier, *The Competitive Consequences of Most-Favored-Nation Provisions*, 27 Antitrust 20, 25 (Spring 2013) ("Our survey of the economics

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[7] Similarly, Abhishek, Jerath, and Zhang find that when sales in the electronic channel lead to a negative effect on demand in the traditional channel, retailers will prefer the agency model, whereas when sales in the electronic channel stimulate demand in the traditional channel, retailers will prefer the wholesale model. Abhishek et al., *supra*, at 26.

literature shows that MFN provisions can promote competition or harm it. … [T]o understand their competitive effects, it may be necessary to consider the plausibility of a range of economic rationales."). And the "forcing" narrative emphasizes the vertical nature of the dynamic at hand. *Apple* is doing the forcing and the publishers are complying with Apple's demands. App. 20a-21a ("The publishers recognized … that the MFN Clause would force them to move Amazon to an agency relationship."). This is not to deny that there are legitimate issues in this case as to whether the MFN provisions were reasonably necessary to Apple's entry efforts or whether they facilitated horizontal collusion. But those are complex issues, requiring rule of reason analysis. A *per se* approach cannot do them justice.

II. The Likelihood That Content Owners Would Raise Some Retail Prices Does Not Justify *Per Se* Condemnation

The District Court decision begins, and as a practical matter ends, with a statement that the decision would explain "how and why the prices for many … 'e-books[]' rose significantly." App. 121a. The Second Circuit majority was likewise willing to apply the *per se* rule based solely on "[t]he district court's assessment of Apple's and the Publisher Defendants' motives, coupled with the unambiguous increase in the prices of their ebooks." App. 67a. Without question, the lower courts' animosity towards those retail price increases drove their willingness to apply the *per se* rule.

This is a dangerous, result-oriented way to justify *per se* condemnation when vertical restraints are at issue. Price effects certainly matter in antitrust

analysis; they are among the most important considerations in a rule of reason analysis. But focusing solely on the short-term nominal change in retail prices is not an appropriate way to choose whether the rule of reason or the *per se* rule should apply to vertical restraints. That implicitly presumes that existing retailer pricing is socially optimal to the point that any increase is *indefensible*. This cannot be squared with the Second Circuit's acknowledgement that "[n]o court can presume to know the proper price of an ebook." App. 68a. It is economic error to approach this case, involving vertical agreements and an agency structure that may prove optimal for consumers in the long run, as if the only fact of economic significance is whether short-term e-books prices increased.

It is significant that Amazon's pricing of the most popular e-books—meaning the titles that should have commanded the highest prices—was below the wholesale price charged by publishers. This could make sense *for Amazon* for entirely benign reasons (e.g., stimulating Kindle sales) or for strategic reasons (e.g., deterring entry or, as Johnson discusses, as a prelude to later "harvesting"). Regardless, publishers could legitimately have a different perspective, and a new platform entrant like Apple would be profoundly concerned with an incumbent's persistent pricing below its content acquisition costs. Even in a business with low marginal costs, that could create a substantial entry barrier.

It was therefore competitively appropriate for Apple to ask itself and the publishers what it could do competitively to disrupt the established order. Not everything would be appropriate, of course; Apple could not ask Amazon to raise its prices, for example.

But what Apple proposed to the publishers, the combination of the agency model, MFNs and price caps, is not price-fixing. It was an alternate business format with considerable efficiency potential. It is fair to ask, if not this, then how was Apple supposed to respond to an entrenched competitor's loss leader pricing strategy that would have rendered its own entry unprofitable? *See* App. 114a-16a (Jacobs, J., dissenting). The government has never advanced a plausible alternative.

The dilemma Apple faced is not substantially different than the disputes between full-price retailers and discounters that have framed countless vertical restraints cases. Imagine a variant on the facts of *Leegin*, where at one point in time a manufacturer of luxury leather goods and accessories sold freely to most any retailer and without any resale price restrictions, as a result of which there was extensive discounting. Neiman Marcus offers to carry the manufacturer's product, which would be a major boon to both sales and the product's luxury image, but only if the manufacturer implements the precise resale price maintenance system that this Court considered. That would almost certainly lead to some increases in retail prices, and Neiman's "motive" to restrain discounting would be clear as well. But would it change the Court's conclusion that the rule of reason applies? *Amici* submit it should not. The Court in *Leegin* properly credited the potential for "a vertical price restraint [to] lead to higher prices for the manufacturer's goods." 551 U.S. at 895. Yet it also properly called it a "mistake[]" to rely "on pricing effects absent a further showing of anticompetitive conduct." *Id.* It noted this was not a new issue, and "[t]he Court … has evaluated other

vertical restraints under the rule of reason even though prices can be increased in the course of promoting procompetitive effects." *Id.* at 895-96 (citing *Business Elecs.*, 485 U.S. at 728).

Perhaps Amazon's below wholesale cost pricing would be unsustainable under the agency agreements, and thus prices would increase. That is an appropriate part of the debate in this case. But it is not any kind of justification for *limiting the debate* to just that one point by applying the *per se* rule. Apple has made serious arguments that e-books output sharply increased as a result of its entry, App. 67a, 112a-13a, and overall e-book prices declined, App. 67a, 201a-02a, 220a n.61. The Second Circuit majority acknowledged "that, in the two years following the conspiracy, prices across the ebook market as a whole fell slightly and total output increased." App. 67a. Even if one did not accept that the verticality of the conduct at issue is enough to ensure rule of reason treatment, verticality plus conflicting evidence of price and output effects must be.

III. That The Agency Model May Have Facilitated Publisher-Level Collusion Does Not Justify *Per Se* Condemnation

The government and the Second Circuit majority justify *per se* condemnation principally on the ground that Apple "orchestrate[d]" horizontal collusion among publishers. *See* App. 55a. The decisions below are therefore steeped in such matters as the order in which meetings took place, "dinners in the private dining rooms of New York restaurants," App. 134a, and generally the interpersonal aspects of the conduct. The government argues that the narrative is sufficiently

similar to "hub and spoke" conspiracy cases to apply the *per se* rule.

Amici submit that the fundamentally vertical nature of Apple's proposals and agreements and their rich economic substance ought not be denied by these distinctly non-economic arguments. By way of the agency model, Apple proposed something substantive and economically innovative. It does not become less vertical, less substantive or less deserving of careful consideration by virtue of how it came about or what legal label is put on it. That is the essence of the error below: non-economic categorization arguments are being used to justify the *per se* rule, and thus a simplistic approach to an unusually complex set of issues.

Consider the "hub and spoke" paradigm, arguably the government's primary argument in support of the *per se* rule. The particular structure of this "hub" and these "spokes" was a new platform entrant trying to get a critical mass of content providers to support the new platform. And from its "hub" position, Apple did not just propose a naked price fixing agreement, nor was one proposed to Apple. Apple proposed the agency structure, the MFNs, the price caps and, importantly, its own efforts to compete with Amazon. *Amici* understand that the government *portrays* Apple as just the self-interested organizer of a horizontal agreement among publishers. But in choosing the *per se* rule or rule of reason, the Court should look to the whole of what Apple indisputably did, not merely to a characterization of one part of it. Apple did a combination of things, most of it highly likely to benefit consumers, but parts possibly harmful depending on the facts. A proper analysis would therefore consider

whether Apple had alternatives to the agency model, whether the MFN provisions were reasonably necessary, whether competition among book publishers is more intense than competition among e-book platforms, whether there is consumer lock-in at the retail level, whether printed books are a good substitute for e-books, and so on. A proper analysis would not condemn Apple's conduct merely because it can be viewed as a "hub" and the publishers as "spokes."

It was not the "hub and spoke" structure that justified *per se* treatment in either *General Motors* or *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 935-36 (7th Cir. 2000). Those cases warranted *per se* treatment because the boycotts at issue were naked restraints; there was no efficiency rationale for excluding competitors. Even if one presumes that Apple's agreements (because of the MFN provisions) had boycott-like effects, this would clearly not be a naked boycott. Apple's MFNs were integral to the agency agreements, and their effects were intertwined with the procompetitive potential of those agreements and Apple's entry into a concentrated market. So it is incorrect to resolve this case, as the government and the courts below did, by saying that it is close enough to *General Motors* and *Toys "R" Us* to warrant *per se* treatment. To so do excludes from consideration all of the economic richness of this case.

The decisions below also erroneously rely on the notion that Apple proposed terms that would make sense to publishers "only if these publishers perceived an opportunity collectively to shift Amazon to agency." App. 45a. Assuming that is true, *amici* do not understand how that robs Apple's proposals of their

procompetitive potential. Apple was likely concerned that publishers would not agree to its proposals if they thought that most others would remain on the wholesale model. That is not unusual; some business arrangements only make sense if they are broadly adopted. The rational *unilateral* move for Apple in such circumstances may be to structure its proposals so that publishers will understand they are unlikely to be alone if they accept. That is not properly understood as orchestrating horizontal collusion. Apple's motivations are not publisher motivations. It did not advance the agency model because it wished to protect printed book sales (far from it), nor because it had a general interest in higher e-book prices (which would reduce demand for Apple's complementary distribution services). Apple's support for the agency model was rooted in the different level of the market at which it intended to compete, the different product it intended to sell, and the competitive conditions it expected to face. Those are distributor interests, lodged downstream from publishers. It is therefore economically incorrect to characterize Apple's actions as joining or "orchestrating" a horizontal publisher conspiracy, and on that basis ignore the economic complexities of the case.

CONCLUSION

This Court should grant the petition.

Respectfully submitted,

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APPENDIX

APPENDIX

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