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

REPLY BRIEF FOR PETITIONER

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The court of appeals ruled that a party engaged in inherently vertical, novel conduct directed at a procompetitive objective (here, new entry) can be found *per se* liable for participating in a horizontal conspiracy if its activities facilitated collusion at a different level of the industry structure. That legal ruling warrants review because it conflicts with decisions of this Court and the Third Circuit and, as confirmed by seven amicus briefs from diverse business and academic perspectives, has created significant uncertainty in the marketplace.

The Solicitor General and the States try to reframe Apple's petition as a dispute about factual findings. It is not. Apple seeks review of the panel majority's *legal* error in concluding that Apple was *per se* liable for "joining" the publishers' horizontal conspiracy. That conclusion was legally wrong because it was not grounded in any findings that Apple's efforts to assemble a critical mass of suppliers for a new e-books platform went beyond methods to persuade publishers to join and negotiate the terms on which Apple and its suppliers would deal.

Respondents' repeated incantation of the word "participation" merely begs the question: When can genuine vertical business conduct, normally subject to the rule of reason, be branded as *per se* unlawful "participation" in a horizontal conspiracy? Recharacterizing an innately vertical course of conduct as horizontal because it assertedly has some horizontal aspect or effect is no answer and reflects the cramped formalism this Court has long rejected. The right answer is that determined business communications and negotiations with suppliers, undertaken to conclude legitimate vertical agreements, are not subject to *per se* condemnation even if that conduct is deemed also to facilitate

suppliers' horizontal pricing collusion. *Leegin Creative Leather Prods.* v. *PSKS, Inc.* 551 U.S. 877, 893 (2007); Pet. 14-18, 21-26.

The decision below runs counter to this Court's multi-decade efforts to "temper, limit, or overrule once strict prohibitions on vertical restraints." *Leegin*, 551 U.S. at 901. If respondents wish to turn back those efforts, they should press that argument on the merits. The petition should be granted, and the Court should reaffirm that vertical arrangements with suppliers—even when they facilitate horizontal collusion—are subject to the rule of reason.

I. THE DECISION BELOW CONFLICTS WITH DECISIONS OF THIS COURT AND THE THIRD CIRCUIT

A. Respondents' mechanistic argument that any actor who "'actually join[s]'" in a horizontal conspiracy may be held *per se* liable, U.S. Br. 19; *see also* States' Br. 20-22, evades the central legal issue in this case: Under what circumstances can vertical conduct directed at legitimate business objectives be condemned as unlawful *per se* on the ground that it amounted to "joining" a horizontal conspiracy?[1]

On that question, the courts of appeals are sharply divided. The decision below cannot be reconciled with the Third Circuit's decision rejecting *per se* liability in *Toledo Mack Sales & Service* v. *Mack Trucks*, 530 F.3d

[1] Contrary to respondents' position, whether to apply the *per se* rule to a particular set of facts is a question of law. *E.g.*, *Monsanto Co.* v. *Spray-Rite Serv.*, 465 U.S. 752, 762-764 (1984) (evaluating whether factual findings supported legal conclusion of unlawful "agreement"); *see also In re Southeastern Milk Antitrust Litig.*, 739 F.3d 262, 271 (6th Cir. 2014); XI Areeda & Hovenkamp, *Antitrust Law* ¶ 1909b (3d ed. 2011).

204 (3d Cir. 2008). The central allegation in *Toledo Mack* was that Mack "agreed to support" an "unlawful conspiracy among [its dealers] to fix prices" by entering into vertical agreements with multiple dealers. *Id.* at 218-219. The plaintiffs "presented direct evidence that Mack agreed with its dealers to support their anticompetitive agreements." *Id*. at 221. The Third Circuit nevertheless applied the rule of reason to Mack's conduct because it was an agreement regarding the terms on which Mack would supply its dealers. Yet under the Second Circuit's (and respondents') open-ended conception of *per se* liability, Mack was surely "participating" in the dealers' horizontal conspiracy.

The United States argues (at 31) that, unlike the lower courts here, *Toledo Mack* did not hold that Mack had "joined" the dealers' horizontal conspiracy. But that is precisely the point. Following *Leegin*, *Toledo Mack* held that a defendant cannot be held *per se* liable for "joining" a horizontal conspiracy simply because it engaged in vertical dealings that served as an organizing or disciplining device for horizontal conspirators. 530 F.3d at 224-225. The Fifth Circuit recently indicated its agreement.[2] In contrast, the majority below based its legal conclusion of "joining" a horizontal con-

[2] *MM Steel* v. *JSW Steel (USA)*, 806 F.3d 835, 849 (5th Cir. 2015), stated that vertically situated entities may be held *per se* liable where they organize a naked horizontal group boycott, citing cases like *Klor's* in which "the vertical participants … actually join[ed] the horizontal conspiracy." 806 F.3d at 849. But *MM Steel* acknowledged *Leegin*'s holding that "vertical agreements … that facilitate horizontal agreements to *regulate prices*" are subject to the rule of reason. *Id.*; *see also infra* Part I.D (explaining inapplicability of naked boycott cases). The Fifth Circuit—like the Third Circuit, but unlike the Second—thus would have applied the rule of reason to Apple's alleged facilitation of a "horizontal agreement[] to *regulate prices*." *MM Steel*, 806 F.3d at 849.

spiracy on factual findings that Apple's conduct in assembling the iBookstore served to organize the publishers' collusion. In doing so, the panel majority placed itself on the "wrong side" of a circuit split, Pet. App. 106a (Jacobs, J., dissenting), and embraced an expansive vision of *per se* liability that is contrary to *Leegin*.[3]

B. Respondents attempt to rewrite *Leegin*. U.S. Br. 20-21; States' Br. 19-20. *Leegin* explained that, although horizontal price-fixing cartels are *per se* unlawful, "to the extent a vertical agreement setting minimum resale prices is entered upon to facilitate [such a] cartel, it, too, would need to be held unlawful *under the rule of reason*." 551 U.S. at 893 (emphasis added). Contrary to the United States' argument (at 21), *Leegin*'s holding and rationale do not turn on whether a vertically situated party might know about, or suspect, horizontal collusion.[4] Economists' Br. 19-20; *see also State Oil* v. *Khan*, 522 U.S. 3, 17 (1997) (use of vertical arrangements to "disguise" *per se* illegal price-fixing "can be appropriately recognized and punished under the rule of reason"). Nor is *Leegin* limited to re-

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[3] *In re Insurance Brokerage Antitrust Litigation*, 618 F.3d 300, 318 (3d Cir. 2010) holds that "virtually all vertical agreements" are evaluated under the rule of reason after *Leegin*, and thus does not help respondents.

[4] The United States' attempt to distinguish *Leegin* (at 21 n.7) because it "declined to consider a separate claim that the [defendant] had 'participated in an unlawful horizontal cartel' among retailers" is misleading: The separate claim was that the defendant *was* a retailer and colluded *with other retailers*. *Leegin*, 551 U.S. at 907-908. And its assertion (at 22 n.8) that *Leegin* requires *automatic* liability under the rule of reason whenever "a particular restraint is used to facilitate a horizontal price-fixing conspiracy" would create an oxymoronic category of "*per se* rule-of-reason liability" never before recognized.

strictions on intra-brand competition. States' Br. 19-20.[5] Respondents' attempt to constrict *Leegin* and resurrect *per se* liability for vertical conduct under a nebulous "participation" framework undermines this Court's effort to roll back "once strict prohibitions on vertical restraints." *Leegin*, 551 U.S. at 901.

C. Respondents argue (U.S. Br. 20, 23-24; States' Br. 26-30) that, regardless of Apple's legitimate vertical objectives, Apple subjected itself to *per se* condemnation because its methods of negotiating agreements with the publishers and the statements it made in the process rendered Apple a member of the publishers' horizontal conspiracy. Respondents' argument departs from the lower courts' holdings and provides no basis for applying the *per se* rule.

The lower courts placed great weight on the terms of the agency agreements themselves. *E.g.*, Pet. App. 20a-21a; *see also id.* 215a (characterizing agreements as a "roadmap for raising retail e-book prices"). They were concerned about supposed competitive harm that flowed from the vertical agency agreements' "forc[ing] the [agency] model" on the e-books industry, resulting in a purported price increase. *Id.* 21a; *see also id.* 215a-216a, 229a. But any such market effect resulted entirely from the vertical restraints contained in Apple's agreements with five publishers, including the most-favored-nation (MFN) clauses, which are vertical in nature and not subject to *per se* condemnation. *E.g.*, Pet.

[5] Inter-brand competition, whose importance *Leegin* and *Khan* stressed, becomes *more* vibrant where, as here, pricing authority is transferred from a single dominant retailer to many price-setters and new retail platforms enable new product features. *E.g.*, Pet. 9 (noting overall decline in prices and new features of iBookstore).

31-32. The lower courts never explained how Apple's negotiation process had independent economic significance separate from the agency agreements themselves, especially given the acknowledgment that none "of the identified negotiation tactics is inherently illegal." Pet. App. 228a.[6]

Nonetheless, respondents now argue that it is those very tactics (*i.e.*, what Apple *said*) to achieve vertical agreements that make Apple *per se* liable. They argue that Apple crossed the line by keeping the publishers "informed of what their competitors were doing," "urg[ing] the publishers to work together," "actively help[ing] to coordinate their efforts," and "us[ing] 'the promise of higher prices as a bargaining chip.'" U.S. Br. 23, 24; *see also* States' Br. 27-30. Apple does not contest these factual findings here, only the erroneous legal conclusion of *per se* liability drawn from them. Apple's recognition of the publishers' concerns regarding Amazon's unchallenged power was a critical means of generating publisher interest in the new platform. *E.g.*, Pet. 23-24 & n.9; *see also*, *e.g.*, Author's Guild Br. 12-15; BSA Br. 8-9. Organizing a critical mass of publishers was a business necessity for Apple, as was telling the publishers about the required critical mass so that suppliers understood the needs of the new platform they were being asked to support. The courts be-

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[6] Respondents do little to challenge Apple's showing that the iBookstore had tremendous procompetitive effects, *e.g.*, Pet. 19; *see also* Pet. App. 94a-95a (Jacobs, J., dissenting), and indeed concede that "total ebook sales increased and overall average prices decreased in the years after [Apple's] entry," U.S. Br. 29 (emphasis omitted). Had the panel considered such real-world effects rather than improperly preempting their consideration, those procompetitive effects would have been critical to the decision, if not decisive.

low never found that this conduct was not genuinely in pursuit of Apple's efforts to launch its platform. Indeed, the district expressly *refused* to find that Apple even "desired higher e-book prices than those offered at Amazon." Pet. App. 244a n.68.

Given that the agency agreements themselves were undisputedly not *per se* illegal, *per se* liability cannot properly turn on efforts to convince the publishers to join the iBookstore. Such "formalistic line drawing" is legal error. *Continental T.V.* v. *GTE Sylvania*, 433 U.S. 36, 58-59 (1977). Even supposing *arguendo* that some facet of Apple's conduct could properly be labeled as nominally horizontal, because Apple encouraged publishers to communicate among themselves about joining the new platform or because certain agreement terms (such as the MFN clause) created an "instrument" for the publishers to collude, Pet. App. 233a, these were intrinsic to a fundamentally vertical undertaking. Condemning Apple *per se* based on such a characterization would be the epitome of formalism. *Leegin*, 551 U.S. at 887-889, 903.

Under respondents' theory, a party organizing a legitimate new vertical venture can be held *per se* liable even if all of its dealings are directed not to exclusionary ends like a group boycott, but to assembling suppliers for the venture. Indeed, the very communications and negotiations that Apple used to assemble critical mass for its multiple-supplier platform *are* the conduct that respondents say triggers *per se* liability. Such a rule chills competition and substantially expands *per se* liability, in contravention of this Court's cases and eco-

nomic reality. *Monsanto Co.* v. *Spray-Rite Serv.*, 465 U.S. 752, 762-764 (1984).[7]

D. Contrary to respondents' statements (*e.g.*, U.S. Br. 18), Apple never contested that a "vertically-related" actor can be *per se* liable. Surely it can if its conduct serves no purpose other than promoting collusion among horizontal competitors over the terms on which they deal with third parties. Pet. 26-28. That was the situation in the naked group-boycott, "hub-and-spoke" cases the Solicitor General cites (at 17-19, 25, 27). In those cases, the challenged conduct's sole objective was to exclude a competitor, a rival of either the vertically situated firm (as in *Klor's* and *Toys "R" Us*) or the horizontally situated colluders (as in *General Motors*). Pet. 26-28; Economists' Br. 22.[8] The vertical actor organized horizontal competitors to collude regarding the terms on which they would deal (or to refuse to deal) with third-party rivals. The conduct condemned as *per se* unlawful was, at best, "facially vertical" sham conduct for no purpose other than an unlawful boycott and was therefore properly characterized as joining an illicit "horizontal combination[]." *Business Elecs.* v. *Sharp Elecs.*, 485 U.S. 717, 731 n.4, 734 & n.5 (1988); *see also Sylvania*, 433 U.S. at 58 n.28; Pet. 27.

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[7] Respondents do not address Apple's demonstration that the decisions below threaten to "'deter or penalize perfectly legitimate conduct'" and "'seriously erode[]'" rules crafted in cases like *Sylvania* (and *Leegin* and *Khan*) to support procompetitive vertical conduct. Pet. 24 n.9, 30 (quoting *Monsanto*, 465 U.S. at 763).

[8] *Interstate Circuit* v. *United States*, 306 U.S. 208, 230-232 (1939), applied the rule of reason. *See also Royal Drug* v. *Group Life & Health Ins.*, 737 F.2d 1433, 1437 (5th Cir. 1984) (*Interstate Circuit*'s "analysis was predicated upon the rule of reason").

Those cases are inapplicable here. Apple's conduct was undisputedly directed to a legitimate, procompetitive objective—new entry—and its agreements involved setting the terms of trade between Apple and the publishers, and no one else.[9]

E. *Per se* condemnation is particularly inappropriate when courts encounter novel economic arrangements. Pet. 18-20. The Solicitor General (at 25-28) confuses this issue. The point is not that the courts lacked experience with horizontal price-fixing conspiracies or even with this particular market. Rather—as respondents in effect concede—they lacked "considerable experience with the type of restraint at issue" here, *Leegin*, 551 U.S. at 886; *see* ACT Br. 3-6, namely, complex vertical contracting and attendant communications and negotiations to assemble a multiple-input digital platform. These novel activities in a new economy setting are particularly ill-suited to *per se* condemnation.[10]

II. RESPONDENTS DO NOT DENY THIS CASE'S IMPORTANCE TO THE NATIONAL ECONOMY

Apple offers a clear rule grounded in this Court's cases: The rule of reason applies to a vertical actor that organizes horizontal competitors, even if such organizing also facilitates horizontal collusion, unless such organizing has no legitimate, vertical, non-sham business

[9] There was no finding that Apple knew *anything* about the most damning facts respondents cite, such as the publishers' "'CEO dinners.'" States' Br. 3.

[10] Respondents admitted below that "no court ha[d] previously considered a restraint" like the one at issue with respect to Apple. Pet. App. 108a (Jacobs, J., dissenting). Even now, the United States posits (at 26) that "the conspirators relied in part on a novel combination of contract terms to effectuate their agreement."

objective. That clear rule protects the procompetitive benefits that often accompany vertical conduct. *Pacific Bell Tel.* v. *Linkline Commc'ns*, 335 U.S. 438, 452-453 (2009) (Court "has repeatedly emphasized the importance of clear rules in antitrust law"). Of course, vertical actors like Apple are not immune to antitrust liability; rather, their conduct must be judged on the basis of real-world economic analysis, *i.e.*, "under the rule of reason." *Leegin*, 551 U.S. at 893; *see also, e.g.*, *In re Sulfuric Acid Antitrust Litig.*, 703 F.3d 1004, 1010-1011 (7th Cir. 2012).

By contrast, neither the decisions below nor respondents' position now provides any meaningful guidance about when a vertical actor might cross the line from conduct with legitimate aims evaluated under the rule of reason to "joining" a *per se* illegal horizontal conspiracy. Respondents deploy conclusory characterizations like "orchestrating" or "participating" and make arguments about competitive effects that are irrelevant under the panel majority's *per se* construct. U.S. Br. 28-30; States' Br. 30-35. But respondents never explain why conduct directed at assembling a new platform, which required a critical mass of publishers, and competing with Amazon should subject Apple to *per se* antitrust liability.[11]

What Judge Jacobs said in dissent below remains true today: "[N]o one has suggested a viable alternative" to Apple's vertical conduct in entering the market. Pet. App. 116a; *see also* Pls.' Proposed Conclusions of Law 39, Dist. Ct. Dkt. No. 233-2 (suggesting that

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[11] The States' assertion that respondents would prevail under the rule of reason (at 31) is a non-starter; only one Second Circuit judge agreed with the district court's perfunctory conclusion on that point, Pet. 29 n.10.

Apple should have simply "remained out of the market"). That is why so many amici—including dozens of scholars from across the ideological spectrum and several industry groups—urge review to ensure that procompetitive conduct is not stymied by the panel majority's decision. *E.g.*, BSA Br. 6-12; WLF Br. 21-25.

The lower courts' erroneous expansion of the *per se* rule casts a long shadow of uncertainty across the economy, particularly in the digital world. Business-model competition, and platform innovation in particular, drive economic progress, as demonstrated by the "countless examples" of "innovative business models introduced by high-tech companies [that] have changed the way that consumers purchase goods and services." BSA Br. 6; *see also id.* 7-12; ICLE Br. 7-9; ACT Br. 6-17. In the wake of the decisions below, firms are left to guess whether and when such novel, vertical conduct could make them a *per se* liable "participant" in a horizontal conspiracy. Billions of dollars of commerce, and countless new products and services, depend on whether risk-taking firms seeking to engage in new forms of vertical activity now face the prospect of *per se* antitrust liability. This Court should resolve the circuit split on that question.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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